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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1428

A. H. ROBINS COMPANY, INC., *et al.*,

Petitioners,

v.

KALMAN ROSS and ANITA ROSS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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A. H. ROBINS COMPANY, INC., *et al.*,
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v.

KALMAN ROSS and ANITA ROSS,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners A. H. Robins Company, Inc. ("Robins"), E. Claiborne Robins, William L. Zimmer, III, E. Claiborne Robins, Jr., George E. Thomas, Kenneth L. Roberts, Charles E. Salzman and Stuart Shumate respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit in *Ross, et ano.* v. *A. H. Robins Company, Inc., et al.,* No. 79-7106 (2d Cir.).

Opinions Below

The opinion of the court of appeals (set forth beginning at page A-1 of the Appendix to this Petition) is reported at 607 F.2d 545.

The opinion of the United States District Court for the Southern District of New York (set forth beginning at page B-1 of the Appendix) is reported at 465 F.Supp. 904. An earlier opinion of the district court (set forth beginning

at page C-1 of the Appendix) is unofficially reported at [1978] CCH Fed.Sec.L.Rep. ¶ 96,388.

Jurisdiction

The judgment of the court of appeals was entered on September 24, 1979. A timely petition for rehearing, with suggestion for rehearing *in banc,* was denied without opinion on December 18, 1979 (the orders are set forth beginning at page D-1 of the Appendix). This petition is filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1976). Respondents consented to a stay of the issuance by the court of appeals of its mandate pending this petition.

Questions Presented

This Court has posed the first question:

1. May "a cause of action . . . be maintained under § 10(b) [of the Securities Exchange Act of 1934] on the basis of actions that would constitute a violation of § 18 [of that Act]", *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 211 n.31 (1976)?

Alternatively and if *arguendo* § 10(b) may be considered without regard to § 18:

2. When the price of a company's stock declines, do previous purchasers of the stock in the open market have an "implied" § 10(b) damage remedy against the company and its directors and officers, who were not sellers of the stock, for a misleading statement of which the purchasers had been unaware and which had not influenced their decision to buy, but which had affected the price at which they bought?

A third question underlies and, if answered in the negative, would moot both these questions:

3. Did Congress intend to create a private damage cause of action—here a cause of action in favor of open-market purchasers of securities—for violations of § 10(b)?

Statutory Provisions

Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b) (1976), Rule 10b-5, 17 C.F.R. § 240.10b-5 (1979), and § 18 of the 1934 Act, 15 U.S.C. § 78r (1976), are set forth beginning at page E-1 of the Appendix.

Statement of the Case

Robins is a manufacturer of pharmaceutical and other products. The seven individual petitioners are present or former directors or officers of Robins. The common stock of Robins is listed on the New York Stock Exchange.

Respondents purchased 100 shares of Robins stock on July 23, 1973. Respondents admit that in making their purchase they were not aware of and did not rely on any statement in Robins' Annual Report on Form 10-K for 1972 filed by Robins with the SEC in early 1973. The market price of Robins stock declined after respondents' purchase. Respondents brought an action on March 23, 1977 alleging that Robins and its directors and officers, who had not traded in Robins stock, had made misleading statements in the 1972 Annual Report on Form 10-K which had artificially affected the market price of Robins stock at the time of respondents' 1973 purchase.

Section 18 of the 1934 Act provides the express remedy for the conduct of which respondents complained. Respondents, however, could not establish the cause of action provided by § 18: they could not claim the reliance required by § 18(a), and their action was time-barred by the limitations periods of § 18(c). Nonetheless, the court of appeals held that respondents had an "implied" cause of action for damages under § 10(b) of the 1934 Act.

As we show below, the "implied" cause of action which the court of appeals created is the cause of action which appeared in the version of § 18 originally introduced in Congress, but which was objected to in the congressional hearings and debate concerning the 1934 Act and was rejected in § 18 as it was enacted in 1934. Although the court of appeals noted that this Court has found "evidence to support the view that § 18(a) was intended to provide the exclusive remedy for misstatements contained in any reports filed with the [SEC]", *Touche Ross & Co.* v. *Redington,* 99 S.Ct. 2479, 2488 (1979), the court declined to examine that evidence. The court disregarded the intent of the Congress which passed the 1934 Act—the intent which recent decisions of this Court have held to be determinative of such questions. The decision below also conflicts with decisions of the courts of appeals of four other circuits in dispensing with reliance as the necessary element of causation in fact when a misrepresentation is in issue.

The complaint (set forth beginning at page F-1 of the Appendix)—Respondents claimed to represent a class of all purchasers of Robins common stock "from April 1972 through in or about July 1974" (F-2). More than 8,800,000 shares of Robins common stock were traded on the New York Stock Exchange during those 28 months.

Respondents alleged that Robins and its directors and officers had schemed to deceive the investing public concerning one of Robins' products, an intrauterine contraceptive device, the Dalkon Shield (F-6), which never accounted for more than 3% of Robins' net sales (F-8). Respondents did not allege any motive for this alleged scheme of deception.

Specifically, respondents alleged, on information and belief (F-1), that:

> —in Robins' 1970 and 1971 annual reports to its stockholders, and in a March 1972 prospectus covering the sale of Robins stock by an educational institution, Robins had, accurately, described that it had acquired the rights to and was successfully marketing the contraceptive device (F-7-8);
>
> —thereafter, during the "class" period from April 1972 through July 1974, Robins and its directors and officers came to know or recklessly disregarded that there were "serious questions" concerning the safety and efficacy of the device (F-8-11);
>
> —Robins' Annual Report on Form 10-K for 1972, which was filed with the SEC in early 1973 as required by § 13(a) of the 1934 Act, 15 U.S.C. § 78m(a) (1976), and in which Robins was required to describe its business including "developments since the beginning of the [1972] fiscal year" (SEC Form 10-K, General Instructions, Part I, Item 1), while otherwise accurate, was misleading because it failed to disclose the "serious questions" concerning the device (F-11-13);
>
> —in May 1974, Robins informed the medical profession by a nationwide mailing to 120,000 physicians that severe complications might result if pregnancy occurred while the device was in place (F-15-16); Robins suspended sale of the device (in June 1974) pending

an investigation by the FDA (F-16); in December 1974, the FDA announced that Robins could continue to market the device under specified conditions (F-16-17); in August "1974" (in fact 1975), Robins announced that it would not resume marketing of the device (F-17); and by March 1975, Robins had been named as a defendant in a number of product liability actions relating to the device (F-17);

—the market price of Robins common stock declined from $19 to $13 per share from early June to July 1974 (F-18-19).

The court of appeals paraphrased the claimed nexus between the alleged wrongdoing of Robins and its directors and officers and the purchase by respondents of Robins stock:

> "[P]laintiffs allege that defendants' misleading statements in reports filed with the S.E.C. artificially affected the market price of Robins' stock. They do not allege, however, that they directly relied on those statements when they purchased the stock." (A-16).

Respondents' brief in the court of appeals was emphatic in stating their position: "they did not read or see, much less actually rely upon, 'filed' documents . . . ."

Respondents alleged that the conduct of Robins and its directors and officers—the making of misleading statements in the filed Annual Report on Form 10-K for 1972—violated § 10(b) and Rule 10b-5 (F-19-20). They also alleged that Robins and the directors and officers were guilty of "common law fraud" and had violated "common law duties" (F-20).

Respondents alleged that the district court had jurisdiction "by Section 27 of the [1934] Act, 15 U.S.C.A. Section

77(aa), and the principle of pendent jurisdiction." (F-1). Diversity jurisdiction was absent since respondents and one of the individual petitioners are citizens of New York.

The decision of the district court—The district court (Lawrence W. Pierce, D.J.) held that the remedy for misleading statements in reports filed with the SEC is that expressly provided by § 18. Reviewing the "legislative scheme embodied in the 1934 Act", the court concluded that "[t]he substantive and procedural requirements contained therein implicitly indicate that Congress intended [§ 18] to be the primary vehicle for remedying the unlawful acts it proscribes" (B-16).

The district court also determined that the complaint failed to aver the alleged fraud with the particularity required by Rule 9(b), Fed.R.Civ.P.. Respondents' pendent common law claims were dismissed without prejudice to the institution of an action in state court (B-18-19).

The decision of the court of appeals—The court of appeals (opinion by Jacob Mishler, D.J.) recognized that it was "called upon to answer a question specifically left open by the Supreme Court, *viz.*, 'whether a cause of action may be maintained under § 10(b) on the basis of actions that would constitute a violation of § 18 [of the 1934 Act]'." (A-11).

The court of appeals was of the view, however, that this Court's decisions in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974); *Cort* v. *Ash,* 422 U.S. 66 (1975); *Cannon* v. *University of Chicago,* 441 U.S. 677 (1979), and *Touche Ross* v. *Redington* were "inapposite" and not "particularly instructive" (A-16-17) concerning this question since, so the court said, they dealt with the issue of when a private civil remedy "should be judicially created" (A-17) while the

"implied" private damage action under § 10(b), so the court also said, was "well established" (A-17).*

The premise of the court's reasoning was that, while "knowledge of and reliance upon the alleged misstatements" are required by § 18, "reliance is presumed" in any § 10(b) action "once the materiality of an omission is established . . . or the material misrepresentation affected the price of stock traded in the open market. . . ." (A-15) (citations omitted; the cited decisions are discussed at pages 13 and 24-25, *infra*).

The court held that to permit respondents to proceed under § 10(b), although they disclaimed any reliance upon the missstatement of which they complained, would not nullify the "terms of the remedy which Congress designed in § 18" (A-20). It rested its *ipse dixit* on *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951), which permitted an action under § 10(b) in respect of conduct which was actionable under § 11 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77k (1976), because the § 10(b) action added the element of fraud (A-20-21). The

* Apparently the court of appeals also thought *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 100 S.Ct. 242 (1979), which was decided by this Court and submitted by Robins to the court of appeals while Robins' petition for rehearing was pending, to be "inapposite" and not "particularly instructive". In contrast, in *Ryan* v. *Ohio Edison Co.*, 611 F.2d 1170, 1178 n.7 (6th Cir. 1979), the Court of Appeals for the Sixth Circuit accepted that this Court's "stricter standard for implying private causes of action" meant that it could no longer follow its decision in *Dann* v. *Studebaker-Packard Corp.*, 288 F.2d 201 (6th Cir. 1961), where it had "implied" a private cause of action under § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a) (1976).

This petition provides, we submit, the appropriate opportunity for this Court to resolve the apparent difference of views concerning the significance which the courts of appeals are to attribute to this Court's recent decisions with respect to the question of when private damage remedies may be inferred from statutes providing none. *See Kissinger* v. *Reporters Committee for Freedom of the Press*, 48 U.S.L.W. 4223, 4226 (U.S. March 3, 1980).

court recognized that § 18 liability "may well" also require scienter (A-22). The court concluded, however, that the plaintiff's burden of pleading and proving scienter in a § 10(b) action, while good faith and lack of knowledge are a defense under § 18, provided the court with a "rationale" for "dispensing with" the reliance requirement inherent in § 18 (A-23) and for dispensing with the other terms of § 18 such as the limitations periods established by § 18(c) (A-15 n. 16) which would have barred respondents' action.

The court of appeals supported this conclusion by its belief that Congress today "would not approve" a contrary result (A-24). The court said that its conclusion both gave "controlling weight to the fundamental policies underlying the securities acts" and recognized that "by careful judicial construction" § 10(b) and Rule 10b-5 had become the primary mechanisms by which open-market investors can seek redress against those who "manipulate the market by fraudulent activity" (A-24).

The court found that the complaint inadequately alleged the "circumstances which would give rise to an inference of fraud" (A-27), but concluded that respondents should be given another opportunity to replead (A-29).

The decision of the district court was reversed and the cause remanded (A-29).*

* This Court has on a number of occasions reviewed the reversal by a court of appeals of a district court decision which had granted a pre-answer motion to dismiss. Important questions of federal law have been answered, and the litigation has been ended or greatly simplified. Examples in the area of the federal securities laws are: *Transamerica Mortgage*, 100 S.Ct. at 244; *Touche Ross* v. *Redington*, 99 S.Ct. at 2484; *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 468 (1977); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 727 (1975).

Chris-Craft Industries, Inc. v. *Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), was reversed four years later *sub nom. Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977). The holding of *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), was overruled in *Transamerica Mortgage*.

Reasons for Granting the Writ

The decision below presents important questions of federal law which should be settled by this Court. It conflicts with the teaching of recent decisions of this Court that Congressional intent is determinative of such questions. It conflicts with the decisions of the courts of appeals of four other circuits.*

1. *Important unsettled questions of federal law*

(a) The question raised and left open by this Court in 1976 in the *Hochfelder* decision—"whether a cause of action may be maintained under § 10(b) on the basis of actions that would constitute a violation of § 18" (425 U.S. at 211 n.31)—is an important question which should be settled by this Court.

As the court of appeals said in stating its view of the elements of an "implied" § 10(b) action: "Whether a plaintiff can rely upon an implied right of action under § 10(b) and Rule 10b-5 or must proceed according to the terms of § 18 can be an issue of controlling significance." (A-15). Here, respondents disclaimed the reliance required by § 18(a). Furthermore, they instituted their action 32 months after the end of the class period they alleged, 34 months after Robins' widely publicized nationwide mailing

* The importance of these questions is evidenced by the fact that the American Institute of Certified Public Accountants and five national broker-dealers are filing briefs as *amici* in support of this Petition.

When the SEC moved in the court of appeals for leave to file an out of time *amicus* brief it did so on the ground that "important federal securities laws issues" were involved.

concerning the device to 120,000 physicians and 44 months after they purchased 100 shares of Robins stock. A § 18 action by respondents would have been barred by either of the limitations periods established by Congress in § 18(c).

Of more importance, and as the court of appeals also said, the resolution of the question involves the "proper accommodation . . . between the judicial and legislative functions" (A-16). The question is thus especially suited for resolution by this Court.*

* The question of whether actions constituting a violation of § 18 may form the basis of an "implied" action under § 10(b) has arisen in a considerable number of cases since the question was posed in *Hochfelder*. The majority of the courts have concluded, as did the district court here, that § 18 provides the exclusive private remedy for misstatements in reports filed with the SEC. *McKee* v. *Federal's Inc.*, [1979] CCH Fed. Sec.L.Rep. ¶96,958 at 96,023 (E.D. Mich. 1979); *Pearlstein* v. *Justice Mortgage Investors*, [1979] CCH Fed.Sec.L.Rep. ¶ 96,760 at 94,974-75 (N.D. Tex. 1978); *Berman* v. *Richford Industries, Inc.*, [1978] CCH Fed.Sec.L.Rep. ¶ 96,518 at 94,013 (S.D.N.Y. 1978); *Kulchok* v. *Government Employees Ins. Co.*, [1977-1978] CCH Fed.Sec.L.Rep. ¶ 96,002 at 91,512 (D.D.C. 1977). *See also McFarland* v. *Memorex Corp.*, No. C-79-2007 (N.D. Cal. Feb. 12, 1980); *Nemo* v. *Allen*, 466 F.Supp. 192, 196 (S.D.N.Y. 1979); *Clayton* v. *Skelly Oil Co.*, [1977-1978] CCH Fed.Sec.L.Rep. ¶ 96,269 at 92,746 n.1 (S.D.N.Y. 1977); *Poller* v. *First Virginia Mortgage and Real Estate Investment Trust*, [1978] CCH Fed.Sec.L.Rep. ¶ 96,564 at 94,352 (E.D. Va. 1978). *See generally* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. Rev. 627 (1963); Note, *The Exclusivity of the Express Remedy Under Section 18(a) of the Securities Exchange Act of 1934*, 46 Geo. Wash. L. Rev. 845 (1978); Note, *Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back into the Toothless Tiger*, 47 Fordham L. Rev. 115 (1978).

A few have reached the contrary result. *Wachovia Bank & Trust Co.* v. *National Student Marketing Corp.*, 461 F.Supp. 999 (D.D.C. 1978) (action dismissed as time-barred, but § 18 argument rejected) *appeal and cross-appeal pending; In re U.S. Financial Securities Litigation*, M.D.L. Dkt. No. 161 (S.D. Cal. Aug. 8, 1977); *Seiden* v. *Nicholson*, 69 F.R.D. 681 (N.D. Ill. 1976).

(b) The alternative second question is addressed to whether causation in fact is an element of an "implied" § 10(b) cause of action in the case of a misrepresentation. This is a question which should be settled by this Court beyond peradventure.

Here, if § 10(b) may be considered without regard to § 18, the question is whether one who purchased, but who in making his purchase decision admittedly did not even read the document of which he complains, has a claim under § 10(b). There was a "purchase" here, but the "connection" between respondents' purchase decision and petitioners' alleged wrongful conduct was absent. There was not even a " 'logical nexus between the alleged fraud and the . . . purchase of a security' ", *Blue Chip Stamps*, 421 U.S. at 736 n.8 (opinion of the Court); *id.* at 761 n.5 (Powell, J., concurring); *id.* at 770 (Blackmun, J., dissenting).*

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* In *Blue Chip Stamps* this Court held that a plaintiff, who allegedly relied upon a misleading prospectus in deciding not to purchase, did not have a § 10(b) claim, expressing concern that "the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good" and quoting Chief Judge Cardozo's reference in *Ultramares Corp.* v. *Touche*, 255 N.Y. 170, 179-80, 174 N.E. 441, 444 (1931) to " 'a liability in an indeterminate amount for an indeterminate time to an indeterminate class' " (421 U.S. at 747-48). *See also Hochfelder*, 425 U.S. at 214-16 n.33. A similar concern was expressed by the Court of Appeals for the Sixth Circuit in *Fridrich* v. *Bradford*, 542 F.2d 307 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977), which denied a § 10(b) claim by open-market sellers against purchasers on inside information. The court said:

> "We express concern similar to that noted by Judge Friendly in his concurring opinion in *SEC* v. *Texas Gulf Sulphur, supra*, that broad extension of the civil remedy under Rule 10b-5 in open market cases 'will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers. . . .' 401 F.2d 833, 867." (542 F.2d at 321 n.28)

The court of appeals erred in its reading of *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), as holding that in any § 10(b) action "reliance is presumed once the materiality of an omission is established" (A-15). There, in a face-to-face transaction "market makers" who "possessed the affirmative duty" to make disclosure stood "mute" (406 U.S. at 153). In that situation this Court held that the "obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact" (406 U.S. at 154). This Court's decision did not create a "presumption" of reliance; the word does not appear in the decision.

In any case, it was not alleged here either that Robins stood "mute" or that it owed respondents some special duty. As the court of appeals said, the allegation was of "misleading statements in reports filed with the S.E.C." (A-16), or, as it also characterized them, "misrepresentations" (A-27). The court of appeals erred in its premise that "reliance is presumed once . . . the material misrepresentation affected the price of stock traded on the open market" (A-15). As is set forth within (pages 21-24, *infra*), decisions of the courts of appeals of four other circuits are to the contrary, and the two court of appeals decisions which the court of appeals cited are doubtful in authority and in relevance (pages 24-25, *infra*).

(c) The third question is unencumbered by the unanswered questions which continue to surround the "implied" § 10(b) cause of action, which are exemplified by the first and second questions presented here and which, because of the "implied" nature of the action, can only be definitively answered by this Court. A negative answer to the third question would severely reduce, if not eliminate, such questions.

Congress did not consider the problems of private suits under § 10(b) at the time of its enactment. *Blue Chip*

Stamps, 421 U.S. at 729. This Court has never held that there is a § 10(b) damage remedy for open-market purchasers such as respondents. This Court has said that a private damage cause of action under § 10(b) has been recognized "in some circumstances", *Santa Fe Industries,* 430 U.S. at 477; *Piper,* 430 U.S. at 25. The single circumstance cited in those decisions is that of *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6 (1971)—an action on behalf of a seller defrauded in a face-to-face transaction. The other decision of this Court in which a damage claim under § 10(b) has been sustained is *Affiliated Ute Citizens.* It too involved sellers defrauded in face-to-face transactions. The express civil liability provisions of the 1933 Act, §§ 11 and 12, 15 U.S.C. §§ 77k and 77l (1976), provide, of course, express remedies for purchasers, but none for sellers.*

The *Superintendent of Insurance* decision gave a perfunctory answer (404 U.S. at 13 n.9) to a question neither presented nor briefed to this Court. It acquiesced in lower court precedent founded upon the statutory tort concept of common law courts which has now been categorically rejected as an argument in the federal courts for the inference from a federal statute of a private damage cause of action not provided by the statute, *Touche Ross* v. *Redington,* 99 S.Ct. at 2485. It disregarded the warnings two years earlier in *SEC* v. *National Securities, Inc.,* 393 U.S. 453 (1969), of "the complications which may arise in determining who, if anyone, may bring private actions under § 10(b)" (393 U.S. at 467 n.9) and against "glib generalizations and unthinking abstractions" (393 U.S. at 465).

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* *See* Freeman, *Implied Remedies Under Rule 10b-5: Are They Only for Defrauded Sellers?,* Nat'l L.J. p. 26 (Dec. 10, 1979).

2. *Conflict with decisions of this Court*

The only reference to Congressional intent by the court of appeals was its mention in a footnote that this Court had said in *Touche Ross* v. *Redington,* 99 S.Ct. at 2488, that "'[t]here is evidence to support the view that § 18(a) was intended to provide the exclusive remedy for misstatements contained in any reports filed with the Commission'" (A-12 n.10). The court did not, however, examine that or any other evidence of Congressional intent.

Instead, the court of appeals reached a conclusion which contradicts Congressional intent and thus conflicts with the teaching of this Court's decisions that the intent of Congress is determinative. This has caused the immediately past General Counsel of the SEC to question "whether the *Ross* decision reflects a faithful application of the policies the Supreme Court has been articulating over the last four years." Pitt, *Judicial Developments in Civil Liabilities Under the Federal Securities Laws* 132, in Univ. of Calif. 7th Annual Securities Regulation Institute (January 18, 1980).

Section 10(b) "does not by its terms provide an express civil remedy for its violation. Nor does the history of this provision provide any indication that Congress considered the problem of private suits under it at the time of its passage." *Blue Chip Stamps,* 421 U.S. at 729; *see also Hochfelder,* 425 U.S. at 196; *Santa Fe Industries,* 430 U.S. at 477.

In contrast, the terms and legislative history of § 18, enacted, of course, as part of the same statute, are "explicit", *cf., Cort* v. *Ash,* 422 U.S. at 78. "[T]he legislative history does not detract from the inference to be drawn from congressional silence [with respect to § 10(b)], but

rather confirms that such silence is purposeful." *Kissinger,* 48 U.S.L.W. at 4226.

The wrongful conduct for which the § 18 remedy is provided is the making of a misleading statement of material fact in a report required to be filed with the SEC, and this is the misconduct alleged here. Section 18 covers not only affirmative misrepresentations in, but also misleading omissions from, filed reports.* The remedy provided is for those who "in reliance upon such statement" purchased or sold securities the price of which was affected by such statement. They may sue for the damages "caused by such reliance" (E-2).

In enacting § 18, Congress considered and rejected a cause of action based solely upon the effect upon market price of a report filed with the SEC—the very "implied" § 10(b) cause of action which the court of appeals created here. The initial version of the provision which became § 18(a) required only that the plaintiff be a person "who shall have purchased or sold a security the price of which may have been affected by such statement". S. 2693, 73d Cong., 2d Sess. § 17(a) (1934). This version which, if enacted, would have provided respondents with an express remedy, was criticized in the hearings concerning the 1934 Act because it permitted recovery of damages by persons, like respondents, "who have not relied upon the inaccurate or misleading statement" and by those who "trade recklessly" as well as "unscrupulous traders" who were not misled by the statements later alleged to be false.*

* The Senate version of § 18 that was sent to the conference committee defined "statement" to include "any omission to state a material fact which is required to be stated . . . or which is necessary to make the statement not misleading." S. 3420, 73d Cong., 2d Sess. 41 (1934). In conference, the provision was deleted because it was "surplusage in view of the fact that a statement obviously may be misleading because of a material omission." H.R. Rep. No. 1838, 73d Cong., 2d Sess. 36 (1934).

Because of this criticism, the bill was redrafted and the two-fold reliance requirement quoted above was added. As explained by Representative Sam Rayburn, then Chairman of the Committee on Interstate and Foreign Commerce:

> "The first provision of the bill as originally written was very much challenged on the ground that reliance should be required. This objection has been met." (78 Cong. Rec. at 7701, April 30, 1934).**

The original version of § 18 also contained a provision barring any action not brought within two years after discovery of the facts constituting the cause of action and six years after the cause of action accrued. Senator Kean thought the two-year period "nothing but blackmail".

> "They discover it after the market has gone down, and after something has happened, and they are looking for mistakes. . . ." (*1934 Senate Hearings* at 6565)

* *Stock Exchange Practices: Hearings on S.Res. 84, S.Res. 56 and S.Res. 97 Before Sen. Comm. on Banking and Currency,* 73d Cong., 2d Sess. at 6638, 7084 (1934) (*"1934 Senate Hearings"*); *Stock Exchange Regulation: Hearing on H.R. 7852 and 8720 Before House Comm. on Interstate and Foreign Commerce,* 73d Cong., 2d Sess. at 226, 656 (1934) (*"1934 House Hearing"*). *See also 1934 Senate Hearings* at 6939, 7186, 7567-68; *1934 House Hearing* at 262, 489.

** *See also* S. Rep. No. 792, 73d Cong., 2d Sess. 21 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 25 (1934). In addition to the element of reliance, Congress established scienter as an element of the cause of action, considering and rejecting liability based on negligence. *Hochfelder,* 425 U.S. at 211 n.31. The original version of § 18(a) provided a defense only for good faith and the "exercise of reasonable care", but § 18(a) as enacted makes good faith and "had no knowledge" a defense (E-2).

Congress also adopted a provision giving the courts authority to require a bond for costs and to assess costs, including attorneys' fees. *See* S. Rep. No. 792, 73d Cong., 2d Sess. 21 (1934). Congress considered this provision "most important", *Blue Chip Stamps,* 421 U.S. at 741.

The bill was revised to require that an action be brought within one year of discovery and three years of accrual of the cause of action. This Court has described this as a "significant" change, *Hochfelder,* 425 U.S. at 212 n.31, but that description is altogether too modest.*

" 'Obviously, then, when Congress wished to provide a private damage remedy, it knew how to do so and did so expressly.' " *Transamerica Mortgage,* 100 S.Ct. at 248, referring to § 18 and quoting *Touche Ross* v. *Redington,* 99 S.Ct. at 2487.

In "dispensing with" the requirement of reliance and the limitations periods and other terms of § 18, the court of appeals created a § 10(b) remedy for the wrongful conduct addressed by § 18 which is fundamentally different from and contradictory of the remedy provided by Congress in § 18. It did so, although in *Touche Ross* v. *Redington* this Court had said that it is "extremely reluctant to imply a cause of action . . . that is significantly broader than the remedy that Congress chose to provide." (99 S.Ct. at 2488). In *Transamerica Mortgage,* decided while the petition for rehearing here was pending, the statutory provision

* Since the New York "blue sky" statute contains no express private damage remedy and has no statute of limitations, federal courts sitting in New York apply the six-year statute governing actions sounding in fraud, New York C.P.L.R. §§ 213(8) and 203(f) (McKinney Supp. 1979-80), to § 10(b) damage actions brought by New York residents. The tendency elsewhere in the country has been to look to the shorter statute of limitations applicable to the private "blue sky" remedy of the forum state.

If respondents had brought their § 10(b) action in Richmond, Virginia, where Robins is headquartered, it would have been time-barred by the two-year Virginia "blue sky" statute of limitations. Va. Code § 13.1-522 (1978); *Newman* v. *Prior,* 518 F.2d 97, 100 (4th Cir. 1975); *Reid* v. *Madison,* 455 F.Supp. 1066, 1067 (E.D. Va. 1978).

This anomaly, which encourages forum shopping, is but one of the difficulties of an "implied" § 10(b) cause of action. Whether it should be permitted to continue would be an appropriate question for resolution by this Court.

in issue proscribed conduct as does § 10(b), but this Court declined to infer a private cause of action for damages, relying upon the "elementary canon" that "where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." (100 S.Ct. at 247). Only last week, this Court reaffirmed that the analysis of *Touche Ross* v. *Redington* and *Transamerica Mortgage* is controlling when it held that no private cause of action may be inferred from the Federal Records Act and the Federal Records Disposal Act which " 'proscribe certain conduct' " and which provide "administrative remedies for violations of the duties [imposed]" but which do not expressly create a private cause of action. *Kissinger,* 48 U.S.L.W. at 4226. Here, the court of appeals not only read into the 1934 Act a broader remedy than Congress enacted, but created one which Congress had considered and rejected.

The court of appeals did not consider the intent of Congress in enacting the 1934 Act which is shown by the language of the statute and confirmed by its legislative history. Yet the question of Congressional intent is the "dispositive" question, *Transamerica Mortgage,* 100 S.Ct. at 249, and the "ultimate" question, *Touche Ross* v. *Redington,* 99 S.Ct. at 2490. A court "must carefully analyze" the factors indicative of Congressional intent "before concluding that Congress intended to make a remedy available to a special class of litigants . . . ." *Cannon,* 441 U.S. at 688. The elements of the cause of action are determined by Congressional intent. *See Davis* v. *Passman,* 99 S.Ct. 2264, 2274 (1979). The determinative intent is that of the Congress which enacted the statutory provision. *Touche Ross* v. *Redington,* 99 S.Ct. at 2488 n.16; *Leroy* v. *Great Western United Corp.,* 99 S.Ct. 2710, 2716 n.14 (1979); *Southeastern Community College* v. *Davis,* 99 S.Ct. 2361, 2370 n.11 (1979); *Oscar Mayer & Co.* v. *Evans,* 441 U.S. 750, 758 (1979).

Ignoring the intent of the Congress which enacted the 1934 Act, the court of appeals relied upon its belief that Congress today would not approve a result different from that which the court chose to reach (A-24). Judicial speculation concerning what Congress would or would not approve is unsound in law and shaky in fact. Despite some initial criticism from some congressmen, Congress has not overturned any of the rulings of this Court beginning with *Blue Chip Stamps* in 1975 which have rejected expansive lower court decisions and arguments of the SEC as *amicus* concerning the desirable, rather than the intended, sweep of the securities laws.

The court of appeals erred in giving "controlling weight" to the view it had of the "fundamental policies underlying the securities acts" and in giving dispositive recognition to the remedy "against those who manipulate the market by fraudulent activity" which, so it said, § 10(b) and Rule 10b-5 have become by "careful judicial construction" (A-24). The court's conclusion effectively repealed not only § 18, but § 9 of the 1934 Act, 15 U.S.C. § 78i (1976), as well. The claim here was that misleading statements in a report filed with the SEC had artificially affected the price of Robins stock, and § 18 provides the express remedy for this wrongful conduct. If the claim had been, but it was not, that a seller of Robins stock, which Robins and the individual petitioners were not, for the purpose of inducing purchases had manipulated the price of the stock by making misleading statements, other than in filed reports, that manipulative conduct would have been proscribed by § 9(a)(4), and § 9(e) would have provided the express private remedy; § 9 is titled "Manipulation of security prices".

Although respondents alleged misconduct which is the subject of § 18, they could not establish either that they

had relied upon the statements in the 1972 Annual Report on Form 10-K as required by § 18(a) or that they had brought their action within the limitations periods of § 18 (c). The court of appeals, however, determined to provide a federal forum for respondents' non-diverse claim.

The court was not free to "improve upon the statutory scheme that Congress enacted into law" or "'to fill any *hiatus* Congress has left in this area'", *Touche Ross* v. *Redington,* 99 S.Ct. at 2490-91. The court was not empowered to rewrite "legislation in accord with [its] own conceptions of prudent public policy", *United States* v. *Rutherford,* 99 S.Ct. 2470, 2477 (1979).

The judicial creation of a remedy, which was not only unintended by Congress but which has been given, as here, dimensions considered and rejected by Congress, poses an issue of the power of the judicial branch not dissimilar in substance from that in *Erie R.R.* v. *Tompkins,* 304 U.S. 64 (1938). No legal relationships, except those among plaintiffs and defendants and the overburdened Federal courts, or justified expectations, depend upon an "implied" § 10(b) cause of action. Private § 10(b) litigation is not a sport or a business (except in a most special sense), nor does it have "unique characteristics and needs" such as were recognized in *Federal Baseball Club, Inc.* v. *National League,* 259 U.S. 200 (1922) and *Flood* v. *Kuhn,* 407 U.S. 258, 282 (1972).

3. *Conflict with decisions of other courts of appeals*

The court of appeals, "dispensing with" the reliance requirement of § 18 (A-23), said that in any § 10(b) action reliance is presumed from the effect of a misrepresentation upon the price of stock traded in the open market (A-15). The court confused damages with liability. The court provided an "implied" remedy for those far more remote

from the actionable conduct than those for whose benefit Congress provided the remedy of § 18. Causation was attenuated to the vanishing point. That in an "implied" § 10(b) action the plaintiff has the burden of proof on the issue of scienter while in a § 18 action the defendant has the burden of proof on the issue of his good faith and lack of knowledge does not provide an acceptable "rationale" for so radical a rewriting of the statute and for the elimination of the basic tort concept of causation in fact.

The decision of the court of appeals conflicts with the decisions of the courts of appeals of four other circuits that when a misrepresentation is in issue the plaintiff must establish reliance.

In *Vervaecke* v. *Chiles, Heider & Co.*, 578 F.2d 713 (8th Cir. 1978), a bond purchaser claimed under § 10(b) when the price of the bonds declined, alleging "fraudulent misstatement and omission within the four corners of an offering prospectus" (578 F.2d at 718). "'[P]laintiff did not even see the offering statements until after the commitment to purchase the securities had been made'" (578 F.2d at 719). The Court of Appeals for the Eighth Circuit held that the element of causation in fact is essential "'else defendants could be held liable to all the world'" (578 F.2d at 715) and affirmed the dismissal of the complaint, stating:

> "[W]e do not think that dispensing with an initial showing of reliance and substituting a presumption of causation in fact in all kinds of 10b-5 fraud is necessary, and that it is not [*sic*] appropriate to apply the *Affiliated Ute* test to this case involving primarily misrepresentation . . . .
>
> "While Vervaecke tries to present this case to us as a case involving primarily nondisclosure, we have carefully examined the pleadings and do not view it as such. Vervaecke's chief complaint concerned alleged material misrepresentations, and omissions in the nature of misrepresentations, in two specific documents . . . ." (578 F.2d at 717)

In *Dupuy* v. *Dupuy*, 551 F.2d 1005 (5th Cir.), *cert. denied*, 434 U.S. 911 (1977), a defrauded seller of stock sued the purchaser under § 10(b) claiming the purchaser had "misrepresented and failed to disclose material facts regarding the value of the stock" (551 F.2d at 1007). The Court of Appeals for the Fifth Circuit refused to transform the § 10(b) action from a compensatory remedy to an enforcement mechanism:

> "[T]o abandon completely the consideration of reliance in fact and reasonable reliance ignores not only the . . . policies of due diligence but also the need for a causal link between the misrepresentation or omission and the injury suffered by the private plaintiff. The cause of action would no longer provide compensation for losses occasioned by the violation of the Act because a plaintiff could sue without relying on the fraud. This would transform the action into an enforcement mechanism." (551 F.2d at 1016)*

In *Holdsworth* v. *Strong*, 545 F.2d 687 (10th Cir. 1976), *cert. denied*, 430 U.S. 955 (1977), defrauded sellers of stock claimed under § 10(b), charging the purchaser with "material misrepresentations and omissions" (545 F.2d at 690). The "omissions" were the alleged failure to state material facts necessary to render not misleading the statements

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* The Court of Appeals for the Fifth Circuit insists that there be causation in fact, but has variously responded to the question of how it is to be demonstrated. *Shores* v. *Sklar*, 610 F.2d 235 (5th Cir. 1980); *Rifkin* v. *Crow*, 574 F.2d 256 (5th Cir. 1978).

which had been made. The Court of Appeals for the Tenth Circuit, sitting *en banc,* held:

> "In the 10b-5 actions, as in common law fraud, there must exist [a] causal connection between the misrepresentation or nondisclosure and the plaintiff's injury.
>
> • • •
>
> "Where, as here, there are affirmative misrepresentations . . . reliance is the appropriate and decisive way to prove the chain of causation . . . .
>
> • • •
>
> "Reliance does not flow from a showing of some abstract wrong. Plaintiff is obligated to prove his reliance and must also prove that it is justifiable." (545 F.2d at 694-96)

In *Landy* v. *FDIC,* 486 F.2d 139 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974), the Court of Appeals for the Third Circuit held that plaintiffs whose depositions revealed that they never saw defendants' reports "therefore failed to support their allegation of an essential element of their cause of action under rule 10b-5." (486 F.2d at 170).

The court of appeals did not refer to these decisions. It cited instead its decision in *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973), where the court (two members of the panel also sat here) held that Chris-Craft had standing to sue for damages under § 14(e). Four years later this Court reversed in *Piper.* The court of appeals held in its 1973 *Chris-Craft* decision that there is a "presumption of reliance where it is logical to presume that reliance in fact existed" (480 F.2d at 375). Apart from its circularity, this statement was not pertinent here since it would not

be "logical" to presume respondents had relied when they expressly disclaimed having done so.

The other decision cited by the court of appeals was *Blackie* v. *Barrack,* 524 F.2d 891 (9th Cir. 1975), *cert. denied,* 429 U.S. 816 (1976), which had never been followed on this point by the court of appeals of another circuit until the decision below. *Blackie* v. *Barrack* involved the determination of class action status. It invoked a rebuttable presumption of reliance for that purpose and it followed, before this Court's *Hochfelder* decision, its view that in an "implied" § 10(b) action there was a flexible standard of duty not necessarily involving scienter. Here, since reliance in fact was concededly absent—respondents admitted they "did not read or see, much less actually rely upon" the statements of which they complained—the court of appeals tacitly changed this entirely doubtful, but at least rebuttable, presumption into a conclusive presumption. A conclusive presumption is, of course, "a process of concealing by fiction a change in the substantive law." F. James & G. Hazard, *Civil Procedure* 253 (2d ed. 1977).

In *Blackie* v. *Barrack,* the court of appeals had said in dictum: "[W]e could, in the exercise of our Article III jurisdiction, transform the 10b-5 suit from its present private compensatory mold by predicating liability to purchasers solely on the materiality of a misrepresentation" (524 F.2d at 908 n.24). The court of appeals here wrongly acted upon that mistaken assertion of Article III jurisdiction.

CONCLUSION

The writ of certiorari should issue.

Respectfully submitted,

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March 14, 1980

APPENDIX

APPENDIX A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1017—August Term, 1978.

(Argued May 25, 1979 Decided September 24, 1979.)

Docket No. 79-7106

KALMAN ROSS and ANITA ROSS,

Appellants,

—against—

A. H. ROBINS COMPANY, INC., E. CLAIBORNE ROBINS, WILLIAM I. ZIMMER, III, E. CLAIBORNE ROBINS, JR., GEORGE E. THOMAS, KENNETH L. ROBERTS, CHARLES E. SALTZMAN and STUART SHUMATE,

Appellees.

Before:

MANSFIELD and GURFEIN, *Circuit Judges,*
and MISHLER,* *District Judge.*

Appeal from a judgment entered in the United States District Court for the Southern District of New York, Lawrence W. Pierce, *District Judge.* The district court dismissed the class action complaint charging violations of

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* Honorable Jacob Mishler, United States District Judge, Eastern District of New York, sitting by designation.

§ 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 on the grounds that: (1) the plaintiffs had failed to plead the alleged fraud with the particularity required by Fed.R.Civ.P. 9(b); and (2) plaintiffs' sole remedy for the acts complained of was under § 18 of the Act.

Reversed and remanded for further proceedings.

WOLF POPPER ROSS WOLF & JONES, New York City (Eric L. Kesman, Marian R. Probst, of counsel), *for Plaintiffs-Appellants.*

CAHILL GORDON & REINDEL, New York City (William E. Hegarty, Joseph W. Muccia, Charles A. Gilman, John C. Koutsos, of counsel), and MCGUIRE, WOODS & BATTLE (Rober H. Patterson, Jr., R. Gordon Smith, Anne Marie Whittemore, of counsel), *for Defendants-Appellees.*

MISHLER, *District Judge:*

This is an appeal from an order of the United States District Court for the Southern District of New York, Pierce, *J.*, dismissing plaintiffs' proposed class action. Plaintiffs, Kalman and Anita Ross, allege that on July 23, 1973 they purchased 100 shares of common stock of the defendant company, A. H. Robins Company, Inc., ("Robins"), a manufacturer and distributor of pharmaceutical products. They instituted this action pursuant to § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, Rule 10b-5, promulgated thereunder, 17 C.F.R. § 240.10b-5 and common law principles, on behalf of all persons who purchased such stock "from April 1972

through in or about July, 1974 . . . and who still owned shares of Robins at the end of said period and who have suffered damages as a result thereof." (Complaint ¶ 2). In addition to Robins, also named as defendants are seven individuals who are identified as directors and/or officers of Robins. The gravamen of the complaint is that the defendants manipulated and artificially inflated the market price of Robins' common stock by disseminating false and misleading information about the effectiveness and safety of the Dalkon Shield, an interuterine birth control device which it manufactured, and by failing to reveal information which indicated that the shield was less effective and more dangerous than the company's earlier public statements had indicated. The district court determined that: (1) to the extent that the alleged false and misleading statements were contained in papers filed with the Securities and Exchange Commission, the plaintiffs could not maintain the action under § 10(b) and Rule 10b-5. Their exclusive remedy was under § 18 of the Exchange Act, 15 U.S.C. § 78r; and (2) the plaintiffs had failed to plead with the degree of specificity required in fraud actions by Rule 9(b) Fed.R.Civ.P. Therefore, the court dismissed the action with prejudice.

We hold that the district court erred in concluding that the action could not be maintained under § 10(b) of the Exchange Act and Rule 10b-5. On the question of the pleadings, we agree with the determination made below that the complaint fails to meet the requirements of Rule 9(b). However, because we are hesitant to preclude the prosecution of a possibly meritorious claim because of defects in the pleadings, we believe that the plaintiffs should be afforded an additional, albeit final opportunity to conform the pleadings to Rule 9(b).

The Complaint

The complaint which is the subject of this appeal was filed in the district court on June 1, 1978.[1] It contains the following pertinent allegations: Robins is a Virginia corporation primarily engaged in the "development, manufacture and distribution of ethical pharmaceutical products and brand name consumer products." (Complaint ¶ 4). The individual defendants were "at all times material hereto" directors of the defendant corporation. Some of the defendants were also officers of Robins. (Complaint ¶ 5—¶ 9).[2] "At all relevant times, the Board of Directors of Robins had the responsibility for the dissemination of information

[1] The original complaint in this action was filed on March 23, 1977. In an opinion and order dated April 6, 1978, Judge Pierce dismissed the complaint for failure to meet the pleading requirements of Rule 9(b) Fed.R.Civ.P. Leave to replead was granted. Thereafter, on May 19, 1978, an amended complaint was filed. A corrected amended complaint was filed June 1, 1978.

[2] Specifically, the complaint alleges:

> ¶ 5. Defendant E. Clairborne Robins is, and at all times material hereto, has been Chairman of the Board of Directors of Robins.
>
> ¶ 6. Defendant William I. Zimmer, III, is a director of Robins and was at all times material hereto, the President and Chief Executive Officer of Robins.
>
> ¶ 7. Defendant E. Clairborne Robins, Jr., is, the President, Chief Executive officer and a director of Robins and was at all times material hereto, the Vice President and a director of Robins.
>
> ¶ 8. Defendant George E. Thomas is, and at all times material hereto, has been the Executive Vice President and a director of Robins.
>
> ¶ 9. Defendants E. Clairborne Robins, E. Clairborne Robins, Jr., Stuart Shumate and William L. Zimmer, III, and George E. Thomas are, and defendants Kenneth C. Roberts and Charles E. Saltzman were at all relevant times hereto, directors of Robins.

to the public, including the statements alleged in the reports referred to in the complaint as well as the information not disclosed to the public as further alleged in the complaint." (Complaint ¶ 10).

The gist of plaintiffs' claim is contained in paragraph 13:

> Since sometime in or about April 1972 and continuing in or about July, 1974, Robins and the individual defendants herein have engaged in a scheme and plan and continuous course of conduct to deceive the investing public, including plaintiffs, as to the true financial condition and prospects of Robins, particularly with respect to matters concerning the Dalkon Shield, and to conceal from the investing public, including plaintiffs, facts, among other things, concerning the safety and efficiency of the Dalkon Shield and the effect of such upon Robins operating and financial condition.

According to paragraph 14:

> Prior to the commencement of the class period, Robins with approval of its Board of Directors which consisted of defendant Robins, Robins, Jr., Roberts, Saltzman and Shumate,[3] prepared, issued and disseminated statements to the investing public highlighting developments with regard to the Dalkon Shield and publicizing its significant impact upon the business affairs of Robins. Said statements also stressed the safety, reliability and efficiency of the Dalkon Shield, particularly with regard to Robins' testing procedures and practices.

[3] Defendants George Thomas and William Zimmer are not alleged to have been directors during this period.

These statements are quoted at length and identified as appearing in Robins' 1970 Annual Report, 1971 Annual Report and a prospectus issued in or about March 1972. (Complaint ¶ 15-¶ 17).[4]

Paragraph 18 is of crucial importance.[5] It charges that

> [d]uring the class period, Robins and the individual defendants knew or recklessly disregarded the fact that there were serious questions as to the safety and efficiency of the Dalkon Shield . . . .

Specifically, it alleges that "among other things" the "defendants knew or recklessly disregarded," *inter alia,* the "facts" that the pregnancy rate from use of the shield "was significantly higher than the low pregnancy rate Robins had indicated in [its] 1970 Annual Report . . .," and that, "the rate of medical removals of the shield required by manifestations of pain, bleeding and infection was significantly higher than . . . indicated in the 1970 Annual Report . . . ." These facts were evidenced by data "found in an updated April 1972 unpublished study on the Shield by Mary Gabrielson . . . ." Paragraph 18 further states the defendants knew or recklessly disregarded the fact that: their conclusions about the shield's safety and effectiveness were based on insufficient date; that in 1972 and 1973 there was an "alarming increase" in the rate of septic abortions and deaths resulting from the shield; and that other "significant health hazards" existed.

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[4] For example, paragraph 15 indicates that Robins' 1970 Annual Report stated, in part, that:

> Clinical tests indicate that the Dalkon Shield offers a low incidence of spontaneous expulsion, cramping and bleeding than other IUD's, as well as greater protection against pregnancy. We feel it has great promise, in the international as well as the domestic market, and have set up a special staff to introduce it widely in a number of areas overseas.

[5] It reads in its entirety:

> During the class period, Robins and the individual defendants knew or recklessly disregarded the fact that there were serious questions as to the safety and efficiency of the Dalkon Shield as evidenced by, among other things, the following facts all of which the said defendants knew or recklessly disregarded: (a) the actual pregnancy rate from the use of the Dalkon Shield was significantly higher than the low pregnancy rate Robins had indicated in the 1970 Annual Report as evidenced, among other things, by the fact that the rate of pregnancy from use of the Dalkon Shield had been found in an updated April 1972 unpublished study on the Shield by Mary Gabrielson to be 5.1% rather than 1.8% as reported in a published study by Ms. Gabrielson approximately a year earlier; (b) that the rate of medical removals of the shield required by manifestations of pain, bleeding and infection was significantly higher than the low medical removal rate Robins had indicated in the 1970 Annual Report as evidenced, among other things, by the fact that the rate of medical removals for the shield required by manifestations of pain, bleeding and infection had been found in the aforementioned April 1972 unpublished study to be 26.4% rather than 14.9% as reported in the aforementioned earlier published study by Ms. Gabrielson; (c) that there were no studies conducted on the Dalkon Shield which involved more than 5.5 months of patient use, and thus there was insufficient clinical data to enable said defendants to reach scientifically valid conclusions concerning the pregnancy and/or medical removal rates for the shield; (f) that the Dalkon Shield was capable of and had caused septic abortions (badly infected miscarriages) in women who became pregnant with the Dalkon Shield in place, (g) that since 1972 there was a rapid and alarming increase in the rate of septic abortions from use of the shield, (h) that there had been at least 20 septic abortions by the end of 1972 and 200 by the end of 1973, (h) that the Dalkon Shield was capable of and had caused death from such septic abortions, (i) that since 1972 there was a rapid and alarming increase in the rate of deaths from septic abortions from use of the shield, (k) that at least 7 women had died from septic abortions in 1972 and 13 by the end of 1973, and (j) that there were other significant health hazards from use of the Dalkon Shield including a substantial number of reported cases of perforation of the uterus, pelvic inflammatory disease and ectopic pregnancy. (Subparagraphs lettered as in original).

Paragraph 20 states that the defendants "failed to make proper and timely disclosure" of these facts and the fact that "Robins was incurring substantial risks to its reputation . . . and substantial risks of substantial liability for injuries from use of the Dalkon Shield."

The complaint also charges that "during the class period" further misleading statements "were made and issued with the knowledge, approval and/or acquiescence of Robins' Board of Directors which consisted at all relevant times of the individual defendants." (Complaint ¶ 21). These statements, language of which is quoted, were allegedly contained in: Robins' 10-K forms for the fiscal years ending December 1972 and December 1973; a press release issued April 19, 1973; press releases dated July 18, 1973, January 31, 1974 and April 18, 1974; and Robins' 1973 Annual Report issued in March 1974. (Complaint ¶ 22-¶ 33). In plaintiffs' view, these statements were misleading in that they continued to speak glowingly of the company and of continued expectations of success and did not disclose the serious problems concerning Robins' continued sale and distribution of the Dalkon Shield.

The named plaintiffs and members of the putative class allegedly "made their purchases of Robins' common stock at prices that were inflated by [these] misleading public reports and press releases and the representations contained therein and by defendants' failure to disclose . . . adverse matter . . . ." (Complaint ¶ 46).

Sometime beginning in or about the middle of May 1974, information about the serious medical problems which were resulting from use of the Dalkon Shield began to be disclosed to the public.[6] As a consequence of this, of re-

[6] It is alleged that during the middle of May, Robins sent a letter to approximately 120,000 physicians nationwide warning that severe complications, including death, had resulted from use of the Shield. (Complaint ¶ 34).

sulting investigations by the Food and Drug Administration, and the Department of Health, Education and Welfare, and the institution of over 500 product liability suits, "Robins' reputation and position in its industry have been jeopardized and its business prospects adversely affected." (Complaint ¶43). The value of its common stock "dropped from approximately $19 to $13 per share on the New York Stock Exchange." (Complaint ¶45).

The defendants' conduct is alleged to have violated §10 (b) and Rule 10b-5.[7] Specifically, it is stated that the "defendants had a duty to disclose [adverse] information [about the Dalkon Shield] in order to correct the false and misleading impression created by [their earlier] statements . . . ." (Complaint ¶20). These statements had indicated that the shield was safe and reliable and would continue to contribute to Robins' sales and earnings.

The District Court Opinion

The defendants moved the district court for an order dismissing the complaint on the grounds that: (1) the court lacked subject matter jurisdiction over the action; (2) the action could not be maintained under § 10(b) and Rule 10b-5 because § 18 of the Exchange Act was the exclusive remedy for the acts complained of; and (3) it failed

[7] Plaintiffs charge, in language almost identical to that of Rule 10b-5, that the defendants:

> (a) employed devices, schemes and artifices to defraud, (b) made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading, or (c) engaged in acts, practices and a course of business that operated as a fraud or deceit upon plaintiffs and others similarly situated in connection with their purchases of Robins stock. (¶ 48).

to comply with the pleading requirements of Rule 9(b) Fed.R.Civ.P.

Judge Pierce rejected the defendants' contention that the complaint essentially stated claims for corporate mismanagement and was therefore not properly brought under the federal securities laws. He concluded that plaintiffs' claim "is arguably within the purview of Section 10(b) unless Section 18 of the Securities Exchange Act of 1934 provides plaintiffs an exclusive remedy." The district court analyzed the substantial differences between sections 10 and 18 of the Exchange Act. *See* discussion *infra*. Reviewing the "legislative scheme embodied in the 1934 Act," the court concluded that "[t]he substantive and procedural requirements contained therein implicitly indicate that Congress intended [§ 18] to be the primary vehicle for remedying the unlawful acts it proscribes." It held that as to material misstatements and omissions contained in papers filed with the S.E.C., the plaintiffs could proceed only under § 18 of the Exchange Act.

The district court also determined that the complaint did not meet the pleading requirement of Rule 9(b) in that it failed to aver the alleged fraud with particularity. Two primary shortcomings in the complaint were noted. First, the complaint failed to "particularize the time when the defendants allegedly knew or recklessly disregarded the undisclosed information." This failing was found to be particularly crucial because the defendants' purported duty to disclose adverse information concerning the shield might have arisen during the class period but after the named plaintiffs' purchase. In that case, they would not be proper class representatives. Secondly, the complaint was held defective because it did not set forth "the circumstances which lead [plaintiffs] to believe that defendants knew or recklessly disregarded the information contained

in the 1972 study prior to their own purchase of Robins common stock." Because the plaintiffs had already been given the opportunity to cure defects in the complaint by repleading, *see* footnote 1, *supra*, the complaint was dismissed without leave to replead. A timely appeal was taken to this court. The S.E.C. appeared as amicus curiae urging reversal of the district court's determination that the action could not be brought under § 10(b) and Rule 10b-5.

I.

The Securities Act of 1933, 15 U.S.C. § 77a *et seq.* ("1933 Act") and the 1934 Act "constitute interrelated components of the federal regulatory scheme governing transactions in securities." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 206, 96 S. Ct. 1375, 1387 (1967). While only a limited number of the Acts' provisions contain authorizations for private civil actions,[8] courts have found implied causes of action in many of the Acts' other sections.[9] It is inevitable that such a complex scheme of regulation, which has developed in judicial decisions spanning almost half a century, will spawn numerous difficult problems regarding the interplay of the Acts' express and implied remedies. In this case, we are called upon to answer a question specifically left open by the Supreme Court, *viz.*, "whether a cause of action may be maintained under § 10(b) on the basis of actions that would constitute a violation of § 18 [of the 1934 Act]." *Ernst & Ernst* v. *Hochfelder, supra,*

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[8] *See* §§ 11, 12, and 15 of the 1933 Act, 15 U.S.C. §§ 77k, 77l, 77o; §§ 9, 16, 18, 20 of the 1934 Act, 15 U.S.C. §§ 78i, 78p, 78r, 78t.

[9] *See* § 17 of the 1933 Act, 15 U.S.C. § 78q; §§ 6, 9, 10, 14, 15 of the 1934 Act, 15 U.S.C. §§ 78f, 78i, 78j, 78m, 78o.

425 U.S. at 211 n. 31, 96 S. Ct. at 1389 n. 31.[10] We have found no Court of Appeals decision which directly addresses this issue.[11] The district courts which have faced the question have adopted divergent views.[12]

Section 18 expressly creates a private remedy for "false or misleading" statements contained in "any application, report or document" filed with the S.E.C. pursuant to the 1934 Act in favor of any person "who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement." [13] *See Touche*

[10] In a subsequent decision not involving § 10(b), *Touche Ross & Co.* v. *Redington*, —— U.S. ——, 99 S. Ct. 2479 (1979), the Court, while indicating that "[t]here is evidence to support the view that § 18(a) was intended to provide the exclusive remedy for misstatements contained in any reports filed with the Commission," *Id.* at ——, 99 S. Ct. at 2488, on the facts before it, expressly found no need to decide the issue. *Id.*

[11] Implicit in this court's decision in *Heit* v. *Weitzen*, 402 F.2d 909 (2d Cir. 1968), *cert. denied*, 395 U.S. 903, 89 S. Ct. 1740 (1969), is the view that actions may be maintained under either provision. However, because the question before us does not appear to have been explicitly raised, we do not view the case as squarely deciding the issue.

[12] *Compare Pearlstein* v. *Justice Mortgage Investors*, [Current] CCH Fed.Sec.L.Rep. ¶ 96,760 at 84,474-75 (N.D.Tex. 1978); *Berman* v. *Richford Industries, Inc.*, [1978] CCH Fed.Sec.L.Rep. ¶ 96,518 at 94,013 (S.D.N.Y. 1978); *Kulchok* v. *Government Employees Insurance Co.*, [1977-1978] CCH Fed.Sec.L.Rep. ¶ 96,002 at 91,512 (D.D.C. 1977) (holding that § 18 is the exclusive remedy in respect of materially misleading statements filed with the S.E.C.), *with Wachovia Bank & Trust Co.* v. *National Student Marketing Corp.*, 461 F. Supp. 969 (D.D.C. 1978); *Seider* v. *Nicholson*, 69 F.R.D. 681 (N.D.Ill. 1976) (reaching opposite conclusion).

[13] Section 18 provides, in its entirety:

Liability for misleading statements

(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement, as provided in subsection (d) of section 780 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

(b) Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

(c) No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

Ross & Co. v. *Redington*, —— U.S. ——, ——, 99 S. Ct. 2479, 2487 (1979). While this remedy has rarely been invoked, the remedy available under § 10(b) and Rule 10b-5 has become "a judicial oak . . . grown from little more than a legislative acorn." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737, 95 S. Ct. 1917, 1926 (1975). By its terms, § 10(b) prohibits a broader range of conduct than does § 18. It makes it "unlawful for any person . . . [t]o use . . . in connection with the purchase or sale, of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may pre-

scribe . . . ."[14] Neither § 10(b) nor Rule 10b-5 promulgated by the S.E.C.[15] explicitly creates any private rights of action. However, notwithstanding the absence of any such provision, it was held in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D.Pa. 1946), that a private action could be maintained to redress a violation of § 10(b) and Rule 10b-5. Some 25 years later, the Supreme Court, in its own words "confirmed with virtually no discussion the overwhelming consensus of the District Courts and Courts of Appeals that such a cause of action did exist." *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 730, 95

[14] The full text of § 10(b) provides:

Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[15] Rule 10b-5 states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

S. Ct. at 1923 (citing *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9, 92 S. Ct. 165, 169 n.9 (1971); *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 150-154, 92 S. Ct. 1456, 1470-1472 (1972)).

Whether a plaintiff can rely upon an implied right of action under § 10(b) and Rule 10b-5 or must proceed according to the terms of § 18 can be an issue of controlling significance. Section 18 requires that a plaintiff establish knowledge of and reliance upon the alleged misstatements contained in any document filed with the S.E.C. *Heit* v. *Weitzen,* 402 F.2d 909, 916 (2d Cir. 1968), *cert. denied,* 395 U.S. 903, 89 S.Ct. 1740 (1969) ("Reliance on the actual [filed] report is an essential prerequisite for a Section 18 action and constructive reliance is not sufficient."); *Jacobson* v. *Peat, Marwick, Mitchell & Co.*, 445 F. Supp. 518, 525 (S.D.N.Y. 1977) ("Plaintiff may only recover if he is able to establish reliance on the actual 10-K form," or upon "relevant parts of the 10-K forms reported in some other source . . . ."). In a § 10(b) action, however, reliance is presumed once the materiality of an omission is established, *Affiliated Ute Citizens* v. *United States, supra,*[16] or the material misrepresentation affected the price of stock traded on the open market. *Blackie* v. *Barrack,* 524 F.2d 891, 906 (9th Cir. 1975); *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 374

[16] There are other significant differences between these statutory provisions. Actions under section 18 are limited by a short statute of limitations (§ 18(c)); the district court may require the plaintiff to post a bond for costs, including attorneys' fees, and may assess such costs at the conclusion of the litigation. (§ 18(a)). *See* note 12 *supra.* However, such security provisions are not applicable in actions under section 10(b). Because no statute of limitations is provided for in § 10(b) actions, courts are required to look to state law.

(2d Cir.), *cert. denied,* 414 U.S. 910, 96 S. Ct. 353 (1973). In this case, plaintiffs allege that defendants' misleading statements in reports filed with the S.E.C. artificially affected the market price of Robins' stock. They do not allege, however, that they directly relied on those statements when they purchased the stock. Thus, while their allegations arguably state a claim under § 10(b) and Rule 10b-5, they omit one of the essential elements of a § 18 claim. Accordingly, even if plaintiffs were able to prove the defendants' wrongdoing, under the district court's view that § 18 provides the exclusive basis of liability for misstatements contained in filed reports, they would be left without a remedy. We are called upon today to determine whether such a result represents the proper accommodation between sections 10(b) and 18 of the 1934 Act and between the judicial and legislative functions.

We begin our analysis by noting that much of the case law relied upon by the parties is inapposite. Defendants argue that disposition of the case before us is controlled by *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453, 94 S. Ct. 690 (1974). There, the Supreme Court refused to imply a cause of action under a provision of the Rail Passenger Service Act of 1970, 45 U.S.C. § 501 *et seq.,* because it found that the express remedies provided in the Act were "the exclusive means to enforce the duties and obligations imposed by the Act." *Id.* at 458, 94 S. Ct. at 693. Relying on this holding, defendants urge that since § 18 provides an express remedy for the acts complained of, we should not imply a remedy for those acts under § 10(b). Plaintiffs on the other hand contend that the factors enunciated by the Supreme Court in *Cort* v. *Ash,* 422 U.S. 66, 78, 95 S. Ct. 2080, 2088 (1975), relevant in determining "whether

a private remedy is implicit in a statute not expressly providing one" are pertinent to our determination. In their view, application of these factors requires a finding that a remedy should be fashioned under § 10(b) for the activities alleged in the complaint.

In our view, neither of these cases is particularly instructive. Both deal primarily with the issue of under what circumstances a private civil remedy should be judicially created for the violation of a particular statutory provision. Other recent Supreme Court decisions have also addressed this issue. *See, e.g., Touche Ross & Co.* v. *Redington, supra; Cannon* v. *University of Chicago,* —— U.S. ——, 99 S. Ct. 1947 (1979).

We, however, are not being asked to create a new judicial remedy. It is well established that a private remedy exists for actions violative of § 10(b) and Rule 10b-5. Rather than being asked to *create* a new remedy, we are being asked to determine whether a party should be allowed to invoke an established remedy in the face of a statute which may, in certain circumstances, provide another remedy for the same conduct. Resolution of this issue turns upon the question of whether allowing invocation of the § 10(b) remedy would impermissibly nullify the limitations and requirements inherent in § 18. We conclude that it would not.

Plaintiffs' position is that where a party can state a claim under § 10(b), it is of no significance that the party cannot proceed under the terms of an express remedy designed to reach the conduct complained of:

> There is simply no historical support for the proposition that Congress, in enacting the general antifraud provision of the Exchange Act, intended it to be con-

> stricted wherever a pattern of conduct falling within its prohibitions also included some single element . . . of a pattern of conduct prohibited by another section of the Act . . . .[17]

This view is supported by the language of the Court in *S.E.C.* v. *National Securities,* 393 U.S. 453, 89 S. Ct. 564 (1969):

> [T]he existence or nonexistence of regulation under § 14 [does] not affect the scope of § 10(b) and Rule 10b-5. The two sections of the Act apply to different sets of situations. Section 10(b) applies to all proscribed conduct in connection with a purchase or sale of any security; § 14 applies to all proxy solicitations, whether or not in connection with a purchase or sale. *The fact that there may well be some overlap is neither unusual nor unfortunate.*

Id. at 468, 89 S. Ct. at 573 (emphasis added). *See also Schaefer* v. *First National Bank of Lincolnwood,* 509 F.2d 1287, 1293 (7th Cir. 1975), *cert. denied,* 425 U.S. 943, 96 S. Ct. 1682 (1976) ("The plaintiffs may make their claim for relief under Rule 10b-5 even though the alleged market rigging scheme also falls squarely within section 9(a)(2)" of the 1934 Act.).

Notwithstanding these cited authorities, we believe that this position is overly broad in light of more recent Su-

[17] Brief for Plaintiffs-Appellants at 64. Plaintiffs add that "[i]f it had been meant [by Congress] merely to cover situations which contained no factual element of any conduct specifically prohibited, it would have been perfectly simple for Congress to have prohibited . . . only those deceptive or manipulative devices 'not otherwise prohibited.'" Brief at 61.

preme Court decisions which have cast considerable doubt on the continuing vitality of the view that the remedies in the securities acts were meant to freely overlap.

In *Ernst & Ernst* v. *Hochfelder, supra,* the Court held that the significant procedural restrictions attendant to actions under the express remedies of the 1933 Act which allow recovery based on negligent conduct

> indicate that the judicially created private damages remedy under § 10(b)—which has no comparable restrictions—cannot be extended, consistently with the intent of Congress, to actions premised on negligent wrongdoing. Such extension would allow causes of action covered by §§ 11, 12(2) and 15 to be brought instead under § 10(b) and thereby nullify the effectiveness of the carefully drawn procedural restrictions on these express actions.

425 U.S. at 210, 96 S. Ct. at 1389. *See also Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 736, 95 S. Ct. at 1925-1926 (In establishing the purchaser-seller requirement in § 10(b) actions, the Court indicated that "[i]t would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.").

Similarly, in *Touche Ross & Co.* v. *Redington, supra,* —— U.S. at ——, 99 S. Ct. at 2488, the Court, in finding it improper to imply a cause of action under § 17 of the 1934 Act, stated:

> [W]here the principal express civil remedy for misstatements in reports [§ 18] . . . is by its terms limited to purchasers and sellers of securities, we are ex-

> tremely reluctant to imply a cause of action in § 17(a) that is significantly broader than the remedy that Congress chose to provide.

These decisions lend at least some support to defendants' position that § 10(b) should be viewed as a "catch-all" provision intended to prevent the use of manipulative and deceptive devices not proscribed by other provisions of the Act and not as a "vehicle for bypassing the carefully drawn express remedies created by Congress." [18]

We do not believe, however, that by permitting the plaintiffs to proceed under § 10(b) in the instant case, we would be nullifying the terms of the remedy which Congress designed in § 18. Our conclusion rests in large part upon this court's decision in *Fischman* v. *Raytheon Manufacturing Co.*, 188 F.2d 783 (2d Cir. 1951). In *Fischman*, both preferred and common stockholders of the defendant company, alleging that the company had made material misrepresentations in a prospectus and registration statement, instituted an action pursuant to § 10(b) and Rule 10b-5 and § 11 of the 1933 Act. Section 11 creates a cause of action in favor of any person acquiring stock where the relevant registration statement contains a material factual misrepresentation.[19] "The common stockholders [had] no claim under § 11 of the 1933 Act, since they purchased no securities which were the subject of the prospectus and

[18] Brief for Defendants-Appellees at 40.

[19] Section 11 of the 1933 Act, 15 U.S.C. § 77k, creates a cause of action at law or in equity in favor of any person acquiring a security where the relevant registration statement contains "an untrue statement of a material fact required to be stated therein or necessary to make the statements therein not misleading . . . (unless it is proved that at the time of such acquisition [the purchaser] knew of such truth or omission). . . ."

registration statement." *Id.* at 786. Nevertheless, this court held that the common stockholders could proceed under § 10(b) and Rule 10b-5 notwithstanding the fact that § 10(b) was not subject to the short statute of limitations or bonding requirement of § 11. Indeed, the court suggested that the plaintiffs could proceed not only under § 10(b) of the 1934 Act, but also under sections 9(a)(4) and 18 of that Act. Portions of the court's opinion may be read as adopting the position that the securities laws provide overlapping remedies. More significantly, however, is the *Fischman* court's articulated rationale for its holding. The court stated that

> when, to conduct actionable under § 11 of the 1933 Act, *there is added the ingredient of fraud,* then that conduct becomes actionable under § 10(b) of the 1934 Act . . . whether or not [the plaintiff] could maintain a suit under § 11 of the 1933 Act.

188 F.2d at 787 (emphasis added).

Defendants here correctly point out that § 11 of the 1933 Act proscribes conduct which is different from that within the purview of § 10(b). Whereas the latter provision, as the Supreme Court's holding in *Ernst & Ernst* v. *Hochfelder, supra,* makes clear, predicates relief upon a showing of fraud or deceit, the former provision does not. It was on this basis that the *Fischman* court, anticipating the holding in *Ernst & Ernst,* sanctioned plaintiffs' action under § 10(b). *See Beecher* v. *Able,* 435 Supp. 397, 412 (S.D.N.Y. 1977) ("Although plaintiffs need not under § 10(b) meet various stringent requirements under § 11, they must sustain a significantly greater burden of proof.") Defendants contend that in the instant case, on the other hand, no

similar justification exists for bypassing the express "reliance" requirement of § 18. We disagree.

Under the rule established in *Ernst & Ernst* v. *Hochfelder, supra,* a party may not be held liable under § 10(b) unless he acted with scienter. It may well be that a similar requirement attaches to § 18 liability. *See Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 211 n.31, 96 S. Ct. at 1389 n.31 ("[T]he legislative history of . . . section [18] suggests something more than negligence on the part of the defendant is required for recovery.") But, we may leave for another day the issue whether something akin to scienter is the sine qua non of a defendant's liability under § 18. In any case, there are substantial differences in the burden facing the plaintiff under the two statutes—differences which justify application of the logic of *Fischman.*

To establish a § 10(b) violation, *the plaintiff must plead and prove* that the defendant acted with scienter in making a material misstatement or omission. A plaintiff seeking recovery under § 18 faces a significantly lighter burden. He must merely plead and prove that a document filed with the Commission contains a material misstatement or omission. If he can show reliance on that statement, liability is established, unless by the very terms of section 18, *"the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading."* (emphasis added). *See Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 211 n.31, 96 S. Ct. at 1389 n.31. As is readily apparent this difference may prove critical. A plaintiff unable to allege those specific facts necessary under Fed.R. Civ.P. 9(b) which would raise a strong inference of scienter, *see* discussion *infra,* would not be able to establish a *prima facie* case under § 10(b). The very same plaintiff, however, could proceed under § 18. Moreover, the ultimate

outcome of the litigation may hinge upon who bears the burden of establishing the defendant's state of mind. In our view the far more difficult task which confronts a plaintiff seeking to proceed under § 10(b) provides a rationale for dispensing with the reliance requirement inherent in § 18. Moreover, for several other reasons we are unwilling to bar plaintiffs from proceeding under § 10(b) and Rule 10b-5.

To now hold, at this late date, that conduct is not proscribed by § 10(b) merely because it is also subject to § 18 would effectively deprive open market investors who relied on misleading market information of any remedy simply because the misinformation happened to be lodged in a form filed with the S.E.C. Such a result would be remarkably incongruous in view of the fact that it is the open market investor who over the years has become one of the prime beneficiaries of the protections afforded by § 10(b) and Rule 10b-5. As we have already indicated, we are not being asked to liberalize even further the recognized implied right of action under § 10(b) or judicially to create a new right in place of that provided by § 18. *Cf. Touche Ross & Co.* v. *Redington, supra.* Rather, plaintiffs only ask that we permit § 10(b) to be used, as it has in the past, to state a claim that is beyond the scope of § 18—the latter section furthering the narrow and particularized objective of encouraging use of and reliance upon records filed with the S.E.C., by expressly authorizing damage suits against those who make them depositaries of materially false or misleading statements. Furthermore, we can conceive of no rational purpose which would be furthered by creating a structure where liability for material misrepresentations adversely affecting investors would vary tremendously depending upon whether the statement hap-

pened to be filed with the S.E.C. Accepting the existence of a private action under § 10(b) and its well established contours, *see Cannon* v. *University of Chicago, supra,* —— U.S. at —— n.13, 99 S. Ct. at 1955 n.13 (recognizing that the very existence of the implied right of action under § 10(b) can be explained historically), we believe that we can fairly say that Congress would not approve of such a disparity. We also believe that holding that plaintiffs must proceed under the terms of § 18 because the statements were filed with the S.E.C. would encourage corporate managers to include their misrepresentations in material filed with the S.E.C., for the sole purpose of insulating themselves from liability under § 10(b) and restricting the class of potential plaintiffs to the unlikely few who actually viewed and relied on the misleading information.

In view of the alternatives that face us, we choose the one which we believe gives controlling weight to the fundamental policies underlying the securities acts and which recognizes that § 10(b) and Rule 10b-5 have become, by careful judicial construction, the primary mechanisms by which open market investors can seek redress against those who manipulate the market by fraudulent activity.

We conclude that even as to those documents filed with the S.E.C., plaintiffs may seek to prosecute their claim under § 10(b) and Rule 10b-5.

II.

Rule 9(b) Fed.R.Civ.P. provides:

> Fraud, Mistake, Condition of Mind.
>
> In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

This rule, which "is a special pleading requirement and contrary to the general approach of simplified pleading adopted by the federal rules," 5 Wright & Miller, FEDERAL PRACTICE AND PROCEDURE: Civil § 1297 at 405, generally serves two important purposes. First, it assures the defendant of " 'fair notice of what the plaintiff's claim is and the grounds upon which it rests.' " *Denny* v. *Barber,* 576 F.2d 465, 469 (2d Cir. 1978) (quoting *Shemtob* v. *Shearson, Hammill & Co.,* 448 F.2d 442, 444 (2d Cir. 1971)). *See* 5 Wright & Miller, *supra,* at 403-404 ("It is the pleading of these matters with precision that serves the rule's purpose by apprising the defendant of the claim against him and of the acts relied upon as constituting the fraud charged."). Secondly, the specificity requirement grows out of "the desire to protect defendants from the harm that comes to their reputations or to their goodwill when they are charged with serious wrongdoing. . . ." *Segal* v. *Gordon,* 467 F.2d 602, 607 (2d Cir. 1972). In the context of securities litigation Rule 9(b) serves an additional important purpose. It operates to diminish the possibility that " 'a plaintiff with a largely groundless claim [will be able] to simply take up the time of a number of other people [by extensive discovery], with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence. . . .' " *Denny* v. *Barber, supra,* 576 F.2d at 470, (quoting *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 741, 95 S. Ct. 1917, 1928 (1975)).[20]

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[20] Of course, Rule 9(b) cannot be viewed in vacuo.

> The requirement of particularity does not abrogate Rule 8, and it should be harmonized with the general directives . . .

In *Segal* v. *Gordon, supra,* the court held:

> "Mere conclusory allegations to the effect that defendant's conduct was fraudulent or in violation of Rule 10b-5 are insufficient; . . . [I]t is now quite clear in this Circuit that allegations with respect to 10b-5 violations will not pass scrutiny if they do not allege with some specificity the statements allegedly constituting the fraud."

467 F.2d at 607 (quoting *Matheson* v. *White Weld & Co.*, 53 F.R.D. 450, 452 (S.D.N.Y. 1971)). Similarly, in *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 378 (2d Cir. 1974), *cert. denied,* 421 U.S. 976, 95 S. Ct. 1976 (1975), the court indicated that a complaint which merely alleged that the defendants engaged "in a course of business which operated as a fraud and deceit on the purchasers and holders of . . . stock" would be insufficient under Rule 9(b). *Accord, Denny* v. *Barber, supra,* 576 F.2d at 470.

These decisions taken together establish that a plaintiff alleging fraud in connection with a securities transaction must specifically allege the acts or omissions upon which his claim rests. It will not do merely to track the language of Rule 10b-5 and rely on such meaningless phrases as "scheme

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of Rule 8 that the pleadings should contain a "short and plain statement of the claim or defense" and that each averment should be "simple, concise and direct." Rule 9(b) does not require nor make legitimate the pleading of detailed evidentiary matter.

2A MOORE'S FEDERAL PRACTICE, ¶ 9.03 at 1929-30. *See* 5 Wright & Miller, FEDERAL PRACTICE AND PROCEDURE: Civil § 1298 at 406. (Rule 9(b) does not render general principles of Rule 8 inapplicable to pleadings alleging fraud). The Second Circuit has very recently expressed this same view that "F.R.Civ.P. 9(b) must be reconciled with F.R.Civ.P. 8(a)(2). . . ." *Denny* v. *Barber, supra,* 576 F.2d at 467.

and conspiracy" or "plan and scheme and course of conduct to deceive." A defendant is entitled to a reasonable opportunity to answer the complaint and must be given adequate information to frame a response.

There is no question that the plaintiffs in this instance adequately identified the alleged "misrepresentations." They point to the following specific documents: 1970 Annual Report (Complaint ¶ 15); 1971 Annual Report (*Id.* ¶ 16); prospectus issued in or about March 1972 (*Id.* ¶ 17); 1972 form 10-K (*Id.* ¶ 22); 1973 form 10-K (*Id.* ¶ 23); press release issued on or about April 19, 1973 (*Id.* ¶ 25); press release issued July 18, 1973 (*Id.* ¶ 27); press release dated January 31, 1974 (*Id.* ¶ 28); 1973 Annual Report (*Id.* ¶ 30); and finally a press release dated April 18, 1974 (*Id.* ¶ 32). However, we believe that the pleading is deficient in other important respects.

The complaint alleges only in a most sketchy fashion circumstances which would give rise to an inference of fraud. The complaint sets forth numerous facts which, it is alleged, indicate that "there were serious questions as to the safety and efficiency of the Dalkon Shield. . . ." (Complaint ¶ 18). Some, but not all, of these facts are alleged to have been contained in a 1972 unpublished report on the Dalkon Shield prepared by a Mary Gabrielson. It is not indicated what relationship, if any, exists between Mary Gabrielson and Robins, or whether plaintiffs have any reason to believe that the defendants were even aware of the report's existence. Plaintiffs also indicate that the defendants' knowledge of the facts contained in paragraph 18 is evidenced by "among other things" the 1972 unpublished report. Plaintiffs should indicate whether they are relying solely on the study or have other reasons to believe that the defendants had knowledge of facts raising serious questions

about the efficiency of the Dalkon Shield. Additionally, knowledge of many of the facts alleged in paragraph 18, *e.g.*, the number of deaths, septic abortions and other complications resulting from the Dalkon Shield in 1972-1973, is in no way attributed to the defendants.

Plaintiffs have also failed to indicate when the defendants allegedly came into possession of this crucial information. No one disputes that the defendants eventually became aware of major safety problems involving their product. The facts alleged in paragraph 34—that by letter dated May 8, 1974 Robins informed approximately 120,000 physicians nationwide that severe complications including death had resulted in instances where the Dalkon Shield remained in place during pregnancy—do give rise to the inference that by 1974 officials at Robins were aware that major medical problems existed. However, it is only if the defendants' knowledge of various problems with the Dalkon Shield coalesced into a duty to disclose prior to July 1973 (the time when the named plaintiffs bought stock in Robins) that the action can be prosecuted as a class action by these named plaintiffs. We believe that it is proper to require the plaintiffs, even at the pleading stage, to fix more definitively the time at which these crucial events in the complaint occurred.

As indicated above, although Rule 9(b) requires that "circumstances constituting fraud . . . shall be stated with particularity" it provides that "[m]alice, intent, *knowledge,* and other condition of mind of a person may be averred generally." (emphasis added). Of course, defendants' awareness of the facts alleged by the plaintiffs in paragraph 18 indicating that there were serious questions about the safety and efficacy of the Dalkon Shield is central to plaintiffs' Rule 10b-5 claim. However, at this stage of the

litigation, we cannot realistically expect plaintiffs to be able to plead defendants' actual knowledge. On the other hand, plaintiffs can be required to supply a factual basis for their conclusory allegations regarding that knowledge. It is reasonable to require that the plaintiffs specifically plead those events which they assert give rise to a strong inference that the defendants had knowledge of the facts contained in paragraph 18 of the complaint or recklessly disregarded their existence. And, of course, plaintiffs must fix the time when these particular events occurred.

Finally, the complaint is deficient in that it fails to specify the time period during which Robins' stock allegedly fell from $19 a share to $13 a share. (Complaint ¶ 45). Absent such a statement, including a claim that the stock has not, since it was acquired, risen above $19 a share, it is impossible to determine whether the named plaintiffs or any members of the proposed class have any viable claim that they sustained a loss due to defendants' alleged misconduct.

However, notwithstanding the deficiencies which exist in the pleading, we believe, as we indicated at the outset, that plaintiffs should be given a final chance to replead.

Conclusion

For the reasons set forth above, the decision of the district court is reversed. The cause is remanded.[21]

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[21] We do not reach the question whether the defendants' alleged failure to update and correct prior statements which were accurate when made constitutes conduct actionable under § 10(b) and Rule 10b-5. In view of the fact that we are sustaining the determination of the district court that the complaint is deficient because it fails to particularize allegations of fraud, we believe it would be premature for us to address this issue at the present time.

APPENDIX B

Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

77 Civ. 1409

KALMAN ROSS and ANITA ROSS,

Plaintiffs,

—v.—

A. H. ROBINS COMPANY, INC., et al.,

Defendants.

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LAWRENCE W. PIERCE, *D.J.*

OPINION AND ORDER

This is a proposed class action brought by two shareholders of the defendant A.H. Robins Company, Inc. ("Robins") against that corporation and several of its directors for violations of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5, as well as for common law fraud and breaches of the fiduciary duties of the individual defendants. The defendants have moved to dismiss the complaint in its entirety on the grounds that: (1) this Court lacks subject matter jurisdiction over the plaintiffs' claims, Fed.R.Civ.P. 12(b)(1); (2) the complaint, as amended, fails to comply with the pleading requirements of Fed.R.Civ.P. 9(b); and (3) there is no implied cause of action under Section 10(b) of the Securities Exchange Act of 1934 since Section 18 of that Act provides the exclusive private remedy for the acts or failures to act complained of, Fed.R.Civ.P. 12 (b)(6). The defendants also move for the dismissal of the state common law claims should the federal claims be dismissed.

FACTS

For the purposes of this motion, the following allegations contained in the amended complaint are taken as true. *Jenkins* v. *McKeithen,* 395 U.S. 411, 421-22 (1969). In 1970, Robins, a manufacturer of pharmaceutical and consumer products, began to produce and market a contraceptive device known as the Dalkon Shield. On July 23, 1973, the plaintiffs purchased 100 shares of Robins common stock. During the period between the introduction of the Shield into the market and plaintiffs' purchase of Robins common stock, Robins published favorable statements concerning the safety, efficiency and marketability of the device. The Shield, however, did not perform as anticipated, and Robins was named as defendant in several products liability actions. Also, in 1972 a report was completed which indicated that the Shield was not as safe or effective as Robins had originally advertised. This report was not published, and Robins did not attempt to modify or correct the earlier statements that had been made concerning the Shield until July, 1974.

The plaintiffs originally instituted this action on March 23, 1977. The defendants moved to dismiss that complaint on grounds similar to those asserted in this motion. That complaint was dismissed by order of this Court dated April 5, 1978 for failure to comply with the particularity requirements of Rule 9(b), among other reasons.

The essence of plaintiffs' claim is that Robins and the individual defendants knew of or recklessly disregarded unfavorable information concerning the Shield. They allegedly failed to correct or modify the original statements made by Robins concerning the Shield in breach of the duty imposed upon them by Section 10(b) and Rule 10b-5. Further, defendants allegedly made, or caused to be made,

statements concerning the Shield or Robins' financial condition without also stating that problems involving the Shield had arisen or that an unpublished report indicated that the Shield may not perform as well as originally stated. These omissions, plaintiffs contend, rendered these later statements misleading in violation of Section 10(b) and Rule 10b-5. The period during which these alleged violations occurred is from April, 1972 through July, 1974. Plaintiffs seek to represent all persons who purchased Robins securities during this period.

DISCUSSION

The defendants have asserted several arguments in support of their motion to dismiss the amended complaint. In the discussion that follows, each of the defendants' arguments will be separately reviewed.

Lack of Subject Matter Jurisdiction

The defendants contend that the amended complaint essentially states a claim for mismanagement and for injuries suffered by Robins because of the errors in judgment by the individual defendants, claims not cognizable under Section 10(b) or Rule 10b-5. Therefore, the defendants argue, the amended complaint should be dismissed pursuant to Fed.R.Civ.P. 12(b)(1) because this Court lacks subject matter jurisdiction.

It is argued that the gravamen of the amended complaint is that there was improper marketing of a product manufactured and sold by Robins. The defendants assert that the plaintiffs' claim lacks the requisite nexus between such marketing and the purchase or sale of securities. Furthermore, defendants argue, the amended complaint alleges an injury which was suffered by the corporate defendants, not

the plaintiffs and, consequently, the plaintiffs lack standing to bring suit.

The theory under which the plaintiffs seek recovery is not, however, so limited. They claim that the defendants failed to correct statements made in documents issued by Robins which were true when made but which became misleading by subsequent events. Specifically, plaintiffs claim that Robins made certain statements in its 1970 and 1971 Annual Reports and in a March, 1972 prospectus. All of these documents were issued during the period 1970 through 1972 and indicated that the Shield was a safe and effective means of contraception and that the device was becoming popular in use. However, in 1972, an unpublished research report indicated that the Shield was neither as effective nor as safe as earlier publicized studies indicated.

Plaintiffs claim that defendants knew of or recklessly disregarded these facts, and that they concealed and failed to make proper disclosure of these facts. The defendants also allegedly failed, until 1974, to disclose that Robins had been named as defendant in several products liability suits during the proposed class period. The effect of these nondisclosures coupled with the earlier Robins statements concerning the Shield, plaintiffs contend, presented a false and inflated picture of the operating and financial condition of Robins when they purchased Robins securities. Had the disclosure been made prior to plaintiffs' purchase, they say, the price of Robins securities would have been lower than that which they paid.

While the plaintiffs cannot, as shareholders, be heard to complain of injuries to the corporation merely because the value of plaintiffs' investment had been indirectly harmed by the acts of the defendant, *Gordon* v. *Funda-*

mental Investors, Inc., 362 F.Supp. 41 (S.D.N.Y. 1973), the amended complaint asserts direct injury to the plaintiffs as a result of the acts of the defendants or of their failure to act. Plaintiffs seek to recover for more than mere alleged acts of mismanagement by the defendants. Their claim is arguably within the purview of Section 10(b) unless Section 18 of the Securities Exchange Act of 1934 provides plaintiffs an exclusive remedy.

Defendants further contend: (1) that they had no duty to revise prior statements made before the proposed class period, in particular statements made in Robins' 1970 and 1971 Annual Reports and in a prospectus issued in 1972; (2) that plaintiffs' claims are too vague; and (3) that plaintiffs rely on post-purchase facts to support their claim.

It is now clear that there is a duty to correct or revise a prior statement which was accurate when made but which has become misleading due to subsequent events. This duty exists so long as the prior statements remain "alive". A. Jacobs, *The Impact of Rule 10b-5* §88.04[b] at 4-14, (rev. 1978) and cases cited therein. Consequently, the defendants owed a duty to plaintiffs to revise any such statements made in Robins' 1970 and 1971 annual reports and in its March, 1972 prospectus if those statements were "alive" at the time the plaintiffs purchased Robins securities. Defendants contend that these reports were ineffective once Robins issued its 1972 Annual Report. The 1972 report was allegedly issued some months prior to plaintiffs' purchase.

Both section 10(b) and Rule 10b-5 are silent as to the effect of time on the duty to correct, but logic compels the conclusion that time may render statements immaterial and end any duty to correct or revise them. In measuring the effect of time in a particular instance, the type of

later information and the importance of earlier information contained in a prior statement must be considered. Thus, general financial information in a two-year old annual report may be stale and immaterial. *Shahmoon* v. *General Dynamics Corp.*, [1973-1974] Fed. Sec. L. Rep. (CCH) ¶94,308 at 95,038 (S.D.N.Y. 1973). However, no general rule of time can be applied to all circumstances. Rather, a "particular duty to correct a specific prior statement exists as long as traders in the market could reasonably rely on the statement." 2 A. Bromberg, *Securities Law, Fraud,* §6.11(543) (1977).

The prior statements at issue would appear to be of a nature that traders in the market might reasonably rely on them until publicly corrected. The 1970 Annual Report allegedly stated that clinical data indicated that the Shield "offers a low incidence of spontaneous expulsion, cramping and bleeding than other IUD's as well as greater protection against pregnancy. We feel it has great promise, in the international as well as domestic market . . ." (Amended Complaint, ¶15). The 1971 Annual Report allegedly states that the Shield was "[o]ne of our most highly successful products during the year . . . . We are also actively developing overseas markets for the Dalkon Shield, in more than a dozen countries. The device already has been purchased for distribution abroad by the International Planned Parenthood Federation, and also by the Pathfinder Fund . . ." (Amended Complaint, ¶16). Finally, the 1972 prospectus generally indicates that the device was marketed in the United States and Canada and was being introduced overseas. (Amended Complaint, ¶17). These statements indicate that the Shield was developing a significant market appeal and arguably projected a favorable future for the Shield. The mere passage of time would not

alone deter the trader in the market from relying on these statements. Such reliance does not appear to this Court to be unreasonable. The defendants therefore had a duty to correct these prior statements when they became aware of subsequent events which rendered those statements misleading.

As for the argument that the amended complaint should be dismissed because it relies on post-purchase facts, the amended complaint's reference to post-purchase documents are for the purpose of supporting the claim that other members of the proposed class have a valid cause of action based on defendants' failure to disclose facts in these later documents. Plaintiffs' references to post-purchase events which occurred within the proposed class period are relevant to the issue of whether these events should have been disclosed during the proposed class period but were not, and whether a violation of federal securities laws had occurred as a result of the nondisclosure. Whether or not these plaintiffs are proper class representatives of all members of the proposed class, including those who purchased Robins securities after these plaintiffs made their purchase, is an issue not presented by this motion. The Court offers no opinion as to that issue.

However, plaintiffs' references to events which occurred *after* the proposed class period are irrelevant as to these claims and must be stricken. In particular, the events referred to in paragraph 38, 39, 40, and 41 should be deleted as irrelevant to the claims asserted in the amended complaint.

Failure to Comply With Pleading Requirements

The defendants contend that the amended complaint has not met the pleading requirements of Fed.R.Civ.P. 9(b)

as to any and all of the defendants. Rule 9(b) provides that all averments of fraud or mistake must be stated with particularity. While this rule must be reconciled with Rule 8(a)(2) which requires only a short statement of the claim showing that the pleader is entitled to relief, *Denny* v. *Barber,* 576 F.2d 465, 467 (2d Cir. 1978), the elements of the claim must be sufficiently particularized to show fraud or to permit an inference of fraud as to the plaintiff. *Id.*

The theory underlying the amended complaint is that the defendants failed to disclose information concerning the Shield which corrects statements made in earlier publications and that subsequent publications were misleading because of that omission. Paragraph 18 of the amended complaint contends that the defendants knew or recklessly disregarded information concerning potential problems with the Shield sometime "[d]uring the [proposed] class period" from April, 1972 through July, 1974. Plaintiffs' claims arose, if at all, on July 23, 1973, the date they purchased Robins securities. The pleading is defective in that it fails to particularize the time when the defendants allegedly knew or recklessly disregarded the undisclosed information. The failure to specifically plead a time reference was a principal defect found in the original complaint in the action, and the plaintiffs have failed again to properly plead.

The time such knowledge was acquired or was recklessly disregarded is relevant in that it determines when the defendants' duty to disclose arose. *Lewis* v. *Black,* [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,638 (E.D.N.Y. 1976). A declaration that the defendants knew or recklessly disregarded this information during the class period does not suffice since the duty to dis-

close may have arisen *during* the class period but *after* the plaintiffs' purchase. In such an instance, plaintiffs may not have a claim and would not be proper class representatives. *Denny* v. *Barber*, 576 F.2d at 468-69.

Nor can the plaintiffs argue that the pleadings are sufficient because the specific time that the defendants became aware of this new information is matter peculiarly within the knowledge of the defendants and, therefore, cannot be specifically pleaded. Plaintiffs must state at the very least the circumstances which lead them to believe that defendants knew or recklessly disregarded the information contained in the 1972 study prior to their own purchase of Robins common stock. *See* 5 Wright and Miller, *Federal Practice and Procedure* § 1297 at 403 (1969). Plaintiffs do not allege that the author of that study had conducted it at the instance of Robins, or had submitted it to Robins at any time, or that Robins should otherwise reasonably be expected to have been aware of its contents. The failure to include such allegations is particularly significant since the report was allegedly unpublished. Absent some allegation which supports an inference of knowledge, the Court cannot assume that the defendants were aware of the information contained in an unpublished study.

Similarly, the allegations of the amended complaint concerning the actions instituted against Robins for products liability which plaintiffs assert were not disclosed have not been sufficiently pleaded. As stated in the order of this Court dismissing the original complaint in this action, absent a statement as to when these product liability actions were instituted, it is not clear whether these plaintiffs have asserted a proper claim. These actions may have been instituted after plaintiffs' purchase. Plaintiffs would not, therefore, have been injured by the alleged nondisclo-

sure complained of. Since the amended complaint lacks sufficient allegations which would enable this Court to determine whether plaintiffs have a proper claim under Section 10(b), it fails to comport with the pleading requirements of Rule 9(b).

Exclusivity of Section 18

The defendants final objection to the amended complaint is that while plaintiffs seek recovery for violation of §10(b) of the Securities Exchange Act of 1934, the amended complaint, in part, alleges facts which would support claims under Section 18 of the Act. Since Section 18 provides the exclusive remedy available to private plaintiffs for acts or omissions which may be within the purview of that section, these plaintiffs cannot assert claims under Section 10(b) which are based on such acts or omission. The plaintiffs argue that no such exclusivity of §18 exists. Rather, they contend, concurrent claims under §10(b) and §18 may be asserted.

A comparison of Section 10(b)[1] and Rule 10b-5[2] with

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[1] Section 10(b), 15 U.S.C. §78j (1970) provides in pertinent part:

"§78j. Manipulative and deceptive devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase of sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

[2] Rule 10b-5, 17 C.F.R. §240.10b-5 promulgated pursuant to Section 10(b) provides:

Section 18[3] reveals several significant differences. Section 10(b) and Rule 10b-5 were designed to regulate a broad

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"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any national securities exchange,

"(1) To employ any device, scheme, or artifice to defraud,

"(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceipt upon any person, in connection with the purchase or sale of any security."

[3] Section 18, 15 U.S.C. §78(r) (1970) provides:

"(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

"(b) Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

"(c) No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued."

range of conduct. *Heit* v. *Weitzen*, 402 F.2d 909 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969). Rule 10b-5 imposes liability upon anyone who makes an untrue statement of a material fact or omits to state a material fact in connection with the purchase or sale of any security. Section 18, in contrast, has a more limited scope and specifically limits liability thereunder to persons who make or cause to be made false or misleading statements in any application, report or document filed under the Securities Act of 1934 or rule promulgated thereunder. Thus, for example, whereas a claim may be asserted under Section 10(b) and Rule 10b-5 for statements made in a press release, e.g., *SEC* v. *Texas Gulf Sulfur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied sub nom., Kline* v. *SEC*, 394 U.S. 976 (1969), such a claim could not be asserted under Section 18 since it does not involve a document filed with the SEC as prescribed by the Act.

A second distinction is that, in cases based on nondisclosure, there is a presumption of reliance by the plaintiff under Section 10(b) once the omitted fact is shown to have been material. *Affiliated Ute Citizens* v. *U.S.*, 406 U.S. 128 (1972). Section 18, however, expressly requires actual knowledge of and reliance upon the misstatements in any document filed with the SEC. 15 U.S.C. §78(r)(a) (1970); *Heit* v. *Weitzen*, 402 F.2d 909, 916 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969) ("reliance on the actual 10-K report is an essential prerequisite for a §18 action and constructive reliance is not sufficient.")

A third notable difference between §18 and §10(b) is that the former provides for a three-year statute of limitations coupled with a one-year discovery rule, 15 U.S.C. §78(r)(a), while Section 10(b) does not specify a statute of limitations. Under the latter, federal courts must refer

to the appropriate limitation under the laws of the forum state. The court will apply the statute of limitations under either state securities laws or state fraud laws.

Finally, Section 18 permits the assessment of an undertaking for the payment of costs of the action. Section 10(b) does not provide for a comparable undertaking.

In resolving the question of whether circumstances which support a claim under Section 18 may also support a claim under Section 10(b), the Court must consider these differences and the roles of each of these sections as designed by Congress. If these sections can reasonably be said to provide mutually exclusive remedies, then events which are actionable under Section 18 will not provide an implicit claim under Section 10(b).

The Supreme Court has indicated that in determining whether an implicit private cause of action may be found, federal courts must consider several factors. Among these factors,[4] the court must consider whether it would be consistent with the underlying purpose of the legislative scheme to imply a private remedy and whether there is any indication of legislative intent. *Cort* v. *Ash*, 422 U.S. 66 (1975); *Redington* v. *Touche Ross & Co.*, Nos. 77-7183, 77-7186 (2d Cir. April 21, 1978), *cert. granted*, 47 U.S.L.W. 3368 (U.S. Nov. 28, 1978) (No. 78-309). A private cause

[4] The factors set forth in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975) are:

(1) Whether plaintiffs belong to the class for whose special benefit the statute was enacted.

(2) Whether there is any indication of legislative intent on the issue.

(3) Whether implication of a right of action is consistent with the policies behind the legislative scheme.

(4) Whether the cause of action is one traditionally relegated to state law.

of action should not be implied under the anti-fraud provisions of the Securities Exchange Act when fulfillment of Congress' purposes may be achieved without it. *Piper* v. *Christ-Craft Industries, Inc.*, 430 U.S. 1, 41 (1977).

Few cases have addressed the issue of whether an implied private cause of action exists under Section 10(b) where Section 18 provides a remedy. In *Kulchok* v. *Government Employees Insurance Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,002 (D.D.C. 1977), the district court found that Section 18 provides an exclusive private remedy. However, that court did not evaluate this issue under the criteria set forth in *Cort* v. *Ash*, and *Piper* v. *Chris-Craft Industries, Inc.* Similarly, in *Berman* v. *Richford Industries, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶96,518 at 94,013 (S.D.N.Y. 1978) the court stated that Section 18 "provides the exclusive remedy for misrepresentations set forth in documents filed with the [SEC]." (Citations omitted). Again, however, this conclusion was reached without an analysis of the legislative scheme embodied in the Act.

Those cases which have reached the conclusion that Section 18 does not provide the exclusive remedy have also relied on authorities other than a legislative analysis to support their positions. In *Seiden* v. *Nicholson*, 69 F.R.D. 681 (N.D. Ill. 1976) and *In re U.S. Financial Securities Litigation*, M.D.L. Docket No. 161 (S.D. Cal. Aug. 8, 1977) the court reached the conclusion that the remedies available under the Act were cumulative and not exclusive on the basis of the doctrine of stare decisis.

A review of the legislative scheme embodied in the 1934 Act indicates that Congress intended that the various sections of the Act would provide a coherent system for remedying and controlling acts of securities fraud. Note,

Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back into the Toothless Tiger, 47 Fordham L. Rev. 115, 123 (1978). As part of that system, Section 18 was purposely designed to provide a private remedy for false and misleading statements in reports filed with the SEC. The substantive and procedural requirements contained therein implicitly indicate that Congress intended this section to be the primary vehicle for remedying the unlawful acts it proscribes.

For example, Section 18 contains specific prerequisites which must be satisfied before a claim may be asserted. It further provides for a defense of good faith and lack of knowledge and for the assessment of an undertaking. These strict express provisions contrast sharply with the general provisions of Section 10(b), as noted earlier in this opinion.

Section 10(b) was designed as a "catch-all" provision to prevent the use of those manipulative devices not already proscribed by other provisions of the Act. In testimony before the House Committee on Interstate and Foreign Commerce, J. M. Landis, a Commissioner of the Federal Trade Commission and a draftsman of the Act, stated that the original proposed statute upon which Section 10(b) was based "gives the general power to the Commission to prescribe the rules and regulations governing *any other manipulative devices.*" Hearings on Stock Exchange Regulations Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 21 (1934) (emphasis added). Other testimony by Thomas G. Corcoran, a principal spokesman for the FTC, stated that the proposed statute was a "catch-all clause to prevent manipulative devices. . . . The Commission should have the authority to deal with *new manipulative devices.*" *Id.* at 115 (emphasis added). These statements support the conclu-

sion that Section 10(b) was not intended to provide a cumulative remedy additional to those expressly provided, but rather was intended to prevent the use of manipulative devices not specifically enumerated in the Act. Therefore, the effect of permitting an implicit private claim under Section 10(b) when Section 18 already provides a remedy would be to undermine the intent of Congress as manifested in Section 18 itself. Further, Congress' purposes in enacting the 1934 Act may be achieved, in this instance, without such a finding of an implied right since Section 18 already provides a remedy for those claiming to be aggrieved.

Nor is this an action similar to that of *Redington* v. *Touche Ross & Co.,* Nos. 77-7183, 77-7186 (2d Cir. April 21, 1978), *cert. granted,* 47 U.S.L.W. 3368 (U.S. Nov. 28, 1978) (No. 78-309) wherein the Court of Appeals held that there was an implied cause of action under Section 17 of the Act and reversed the district court's ruling that Section 18 provided plaintiffs an exclusive remedy. The appellate court held that Section 18 did not provide the exclusive remedy available to customers of a brokerage firm against an accountant whose audits of that firm were false or misleading. The Court reasoned that since misstatements in a Section 17 report would not affect the price of shares of the various issuers which were in the hands of the broker's customers, a strict application of the provisions of Section 18 would leave those customers without a remedy. However, the court held that the provisions of Section 18 would apply to all investors who seek relief as *investors* thereby apparently limiting the applicability of its holding.

This apparent limitation of its holding may be interpreted as suggesting that *shareholders* who seek relief

from *issuers* for acts of the issuer which would support a claim under Section 18 must pursue an action under that section and may not seek relief under Section 17. Similarly, since the shareholder plaintiffs in this action have alleged facts which would appear to support an action under Section 18 against Robins—assuming that they could satisfy the prerequisites thereof—*Redington* offers no support for their position that they have an implied private claim under Section 10(b). Moreover, the circumstances which compelled the court in *Redington* to find an implied cause of action under Section 17 are not present in this action. More specifically, in *Redington* the plaintiffs could not secure relief from the acts complained of under Section 18, whereas here the plaintiffs have asserted allegations which appear to support a claim for which relief could be granted under Section 18, if the conditions of that section are otherwise met. Accordingly, insofar as the amended complaint alleges omissions and misleading statements in documents filed with the SEC which allegations appear to support a cause of action under Section 18, the motion to dismiss is granted.

CONCLUSION

1. Plaintiffs have generally stated a claim cognizable under Section 10(b) and Rule 10b-5 with respect to statements made in Robins' 1970 and 1971 Annual Reports and March, 1972 prospectus which were not modified or corrected, and with respect to the alleged nondisclosures in documents or publications which were issued by Robins but not filed with the SEC. However, they have failed to plead their claims with the particularity required by Fed. R.Civ.P. 9(b). This defect was the basis of this Court's dismissal of the original complaint filed in this action.

(See Opinion and Order of this Court dated April 5, 1978 at p.13). As these defendants have previously been granted the opportunity to remedy this defect and have failed to do so, the amended complaint is dismissed as to this portion of plaintiffs' claims without leave to replead.

2. Those claims relating to documents filed with the SEC during the proposed class period must be dismissed as being improperly asserted under Section 10(b) and Rule 10b-5.

3. Since plaintiffs' claims under federal securities laws have been dismissed, the pendent state claims asserted in this action are dismissed without prejudice. *United Mine Workers of America* v. *Gibbs,* 383 U.S. 715 (1966).

The Clerk of the Court is hereby ordered to enter judgment in accordance with this Opinion and Order.

SO ORDERED.

Dated: New York, New York
January 8, 1979

/s/ LAWRENCE W. PIERCE
LAWRENCE W. PIERCE
U. S. D. J.

APPENDIX C

Earlier Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

77 Civ. 1409

KALMAN ROSS and ANITA ROSS,

Plaintiffs,

—v.—

A. H. ROBINS COMPANY, INC., et al.,

Defendants.

APPEARANCES:

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Lawrence W. Pierce, *D.J.*

Opinion and Order

Plaintiffs, shareholders of A.H. Robins Company, Inc. (Robins), bring this proposed class action on behalf of themselves and other purchasers of Robins securities for violations of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(6); Rule 10b-5, 17 C.F.R. §240.10b-5; and various principles of common law. Named as defendants are Robins and seventeen directors and officers of that corporation.

Robins is a manufacturer of pharmaceutical and consumer products. In 1970, it produced and marketed a contraceptive device which was known as the Dalkon Shield. In plaintiffs' own words:

> "The instant action arises, in essence, out of the defendants' marketing and distribution of Robins' intrauterine device ("IUD"), commonly known as the Dalkon Shield, without disclosing to the investing public, including plaintiffs and the other members of the class, the fact, among other things, that defendants were advertising the Dalkon Shield on the basis of false and misleading statements and statistics; that there were

> substantial indications of various health hazards arising out of the utilization of the Dalkon Shield; that, in marketing and distributing the Dalkon Shield, Robins was incurring substantial risks to its reputation and substantial risk of liability for injury to users of the Dalkon Shield, and that public disclosure of the true facts concerning the hazards and risks of using the Dalkon Shield would result in loss of sales and revenues to Robins." (Page 3 of Plaintiff's Memorandum in Opposition to Motions of Defendants to Dismiss the Complaint).

Plaintiffs further allege that "A.H. Robins and the individual defendants herein have engaged in a plan and scheme and course of conduct to deceive the investing public, including plaintiffs, as to the true financial condition and prospects of A.H. Robins, particularly in relation to the testing, production and distribution of its IUD, the Dalkon Shield." (Complaint ¶13).

The Complaint continues:

> "During the period in question, A.H. Robins with the knowledge, approval and/or acquiescence of the individual defendants, issued, disseminated and circulated to the investing public, including plaintiffs and other members of the Class similarly situated, false and misleading public reports consisting of annual reports, prospectus, 10-Qs, 8 Ks and press releases with the New York Stock Exchange, the Securities and Exchange Commission and other governmental agencies, in which they failed to disclose, among other things, facts indicating (1) potential or actual dangers in the use of the Dalkon Shield, (2) serious flaws in the design and testing of such IUD for side effects, expulsion,

and continuation rates and dangers resulting from pregnancy with the Dalkon Shield in place, which impeach the scientific integrity of A.H. Robins' testing and reporting procedures, and (3) facts showing the potential impact upon A.H. Robins' sales, earnings and operations of investigations of the Dalkon Shield and of A.H. Robins' procedures and practices by the F.D.A. (including, *inter alia,* the possibility that the Dalkon Shield might be removed from the market or at least might be required to be distributed only under severely restricted conditions), and of product liability cases arising out of injuries from the use of the Dalkon Shield and by the public disclosure of facts impeaching the reliability of A.H. Robins' and undermining its standing and reputation as a developer and producer of reliable, efficacious and safe pharmaceutical products." (Complaint ¶14).

Paragraph 16 through 18 of the Complaint contains language from advertisements to the medical field and from patient brochures. Plaintiffs claim:

"Said advertisements and the representations contained therein had the effect, as Robins and the individual defendants knew, of manipulating the market price for A.H. Robins securities in that *inter alia,* they were designated [*sic*] to promote, stimulate and to increase (a) the sales of the Dalkon Shield and A.H. Robins earnings, and profits therefrom and (b) the standing and reputation of A.H. Robins as a developer and producer of safe, reliable and effacious [*sic*], ethical pharmaceutical products, thereby affecting A.H. Robins sales, earnings, growth and overall prosperity." (Complaint ¶20).

Defendants move to dismiss, under Rule 12(b)(6) of the Federal Rules of Civil Procedure, that part of the Complaint alleging that the representations in the advertisements and patient brochures constitute violations of the Securities Exchange Act. They contend that the pleadings fail to state allegations which satisfy the "in connection" requirement of section 10(b) and Rule 10b-5. Defendants also move to dismiss that part of the Complaint alleging that the reports filed with the Securities and Exchange Commission contained material omissions in violation of section 10(b) and Rule 10b-5. It is maintained that since Section 18 of the Securities Exchange Act, 15 U.S.C. §78r, provides the exclusive private remedy for fraudulent misrepresentations and omissions contained in reports filed with the SEC, plaintiffs have no implied private cause of action under section 10(b). See *Kulchok* v. *Government Employees Ins. Co.,* [1977-1978 Transfer Binder] CCH Fed.Sec.L.Rep. ¶96,002 (D.D.C. 1977). With respect to the omissions contained in the other reports enumerated in the Complaint which are not deemed filed with the SEC, defendants contend that the pleadings are insufficient under the particularity requirements of Rule 9(b) of the Federal Rules of Civil Procedure. Finally, should this Court grant these motions, defendants also move to dismiss the pendent state claims. If the Court does not grant these motions, the defendants maintain that the pendent state claims nevertheless should be dismissed for lack of sufficient particularity in the pleadings.

The "In-Connection" Requirement

The initial question presented to this Court is whether or not the claim that the Robins advertisements and patient brochures were materially false and misleading is within

the purview of section 10(b) and Rule 10b-5. For the Court to find actionable grounds from these allegations it must determine that the acts complained of constitute a manipulative or deceptive device and that this device was employed in connection with the purchase or sale of Robins securities. The gravamen of this aspect of the complaint is that the plaintiffs and members of the class made their purchases of A.H. Robins common stock at prices that were inflated due to the misleading advertisements and brochures which were circulated among members of the investing public. The issue presented is whether or not those advertisements and patient brochures are manipulative devices within the meaning of the Act.

The defendants argue that advertisements in medical journals and patient brochures are not a sufficient basis for bringing a section 10(b) or Rule 10b-5 action. See A. Jacobs, *The Impact of Rule 10b-5* §65 (1976). They claim that liability extends only to assertions which are made in a manner reasonably calculated to influence the investing public such as by means of the financial media. *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom., Kline* v. *SEC*, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed. 2d 756 (1969), *on remand*, 312 F.Supp. 77 (S.D.N.Y. 1970), *modified*, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005, 92 S.Ct. 561, 30 L.Ed. 2d 558 (1971); *Landy* v. *Federal Deposit Insurance Corp.*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Wessel* v. *Buhler*, 437 F.2d 279, 282 (9th Cir. 1971).

In *SEC* v. *Texas Gulf Sulphur, supra*, it was established in this Circuit that a claim under section 10(b) must involve a device which is of a sort that would cause a reasonable investor to rely upon it. The character of the device must be such that it is capable of being fairly viewed as

a manipulative or deceptive device. *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 467 (1977). Thus, the medium through which statements are made may provide the nexus between the misleading statement or material omission and the fraud averred.

The Robins advertisements in medical journals and patient brochures do not alone provide a sufficient nexus for a section 10(b) violation. As noted by one commentator, a balance sheet of a company is more likely to influence an investor than is an advertisement for a new product. Feuerstein, *The Corporation's Obligation of Disclosure Under the Federal Securities Laws When It is Not Trading in its Stock*, 15 N.Y.L.F. 385 (1969). "Publication in the Wall Street Journal or an announcement at a meeting of security analysts is more likely to satisfy the nexus than an article or advertisement in a women's magazine or trade journal. The second important factor is the subject matter of the statement. An assertion regarding earnings has more chance of satisfying the nexus than a statement about a new product." A. Jacobs, *The Impact of Rule 10b-5* §65, at 3-234 (rev. ed. 1977).

Defendants contend that the advertisements and patient brochures were calculated only to influence the medical decisions of doctors and their patients, not the investment decisions of investors. Plaintiffs apparently agree: "plaintiffs do not allege that the advertisement and patient brochures constitute false and misleading documents which were issued to induce purchases of Robins securities, but rather that the circulation and dissemination of said false advertisements and patient brochures which had the effect of fraudulently increasing Robins' overall sales growth and prosperity, constituted a form of market manipulation which inflated the price of Robins' stock." (Note at p. 33

of Plaintiffs' Memorandum in Opposition to Motions of Defendants to Dismiss the Complaint).

The Court finds that plaintiffs have not posited a sufficient causal nexus to make the claims based on the advertisements and patient brochures actionable under Rule 10b-5. "'Congress by §10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.'" *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 479 (1977), quoting *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 12 (1971). Were plaintiffs' reasoning sufficient, every company which reported increased earnings would be liable to suit for manipulating the price of its stock in an attempt to increase earnings. The Court agrees with the defendants that the only "connection" which plaintiffs have made in their Complaint with any degree of particularity is between an alleged misleading marketing campaign and the sale of a product.

Accordingly, the Court grants defendants' motion to dismiss those portions of the Complaint which allege that the advertisements in the medical journals and patient brochures constitute violations of section 10(b) and Rule 10b-5.

Sufficiency of the Pleadings

Defendants also move to dismiss the Complaint on the ground that it fails to state which particular reports and press releases the plaintiffs charge contained material omissions, and the role each individual defendant played in the alleged wrongful conduct. Plaintiffs respond that the Complaint is sufficient as it identifies the types of documents involved, states the time period in which they were

issued, and specifies the omissions complained of. They also contend that the role of each defendant is matter particularly within the knowledge of each defendant and the rule requiring particularity should be relaxed with respect to descriptions of the roles played by corporate officers in the averred fraud.

Rule 9(b) of the Federal Rules of Civil Procedure provides that all averments of fraud or mistake must state with particularity the circumstances constituting fraud or mistake. Conclusory allegations that a defendant's conduct was fraudulent or violative of section 10(b) or Rule 10b-5 do not satisfy the requirements of Rule 9. *Shemtob* v. *Shearson, Hammill & Co.,* 448 F.2d 442 (2d Cir. 1971); *Segal* v. *Gordon,* 467 F.2d 602 (2d Cir. 1972). While Rule 9 must be reconciled with Rule 8 which requires a short and concise statement of claims, *Felton* v. *Walston & Co.,* 508 F.2d 577 (2d Cir. 1974), the pleadings must be sufficient to apprise a defendant of the claims against him and of the acts relied upon which constitute the fraud charged. 5 C. Wright & A. Miller, *Federal Practice and Procedure* §1297, at 404 (1969). In this regard, "[t]here must be . . . identification of what statements were made and in what respect they were false, misleading or inaccurate or what omissions were made and why the statements made are believed to be misleading." *Rich* v. *Touche Ross & Co.,* 68 F.R.D. 243, 246 (S.D.N.Y. 1975). The pleadings must be "particularized enough to give notice to the defendants of what conduct is complained of to enable the defendants to prepare a defense to such a claim of misconduct." *Gross* v. *Diversified Mortgage Investors,* [1977-1978 Transfer Binder], CCH Fed.Sec.L.Rep. ¶ 96,137 (S.D.N.Y. 1973).

As to the press releases, the Complaint charges "That A. H. Robins followed a policy of reporting the results of

only published studies on the effectiveness, safety and reliability of the Dalkon Shield and did not reveal or report the results of public, but unpublished, reports on the Dalkon Shield's safety, effectiveness or reliability." (Complaint ¶ 22-H). The Complaint does not contain any more detail regarding specific press releases. "The familiar plaint that the details of an alleged fraud lie in defendant's ken has no convincing ring when the details at issue are the identities of documents that have been widely disseminated to and assimilated by the investing public." *Denny* v. *Barber*, 73 F.R.D. 6, 9 (S.D.N.Y. 1976). Such lack of identification of publications which although identified as spanning three years, might comprise a significant number, compels the Court to dismiss, with leave to amend, the allegations in the Complaint regarding press releases.

As to the remaining publications, the essence of the allegations is that the annual reports, prospectuses, 10 Qs and 8 Ks filed with the SEC during the period 1972 through 1974 were false and misleading in that by their omissions they created the false and misleading impression that Robins would continue to have increased earnings based on the sales of the Dalkon Shield. By its language, Rule 10b-5 provides that "[i]t shall be unlawful for any person . . . to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading," or 17 C.F.R. §240.10b-5 (1977). "[A]n omission is not actionable unless it is a material fact that is omitted and unless that material fact adversely affects the reliability of other statements." *Parsons* v. *Hornblower & Weeks, Hemphill Noyes*, [1976-1977 Transfer Binder] CCH Fed.Sec. L.Rep. ¶95,885 (M.D.N.C. 1977). As in *Parsons*, the plaintiffs herein have failed to identify any statements that were made misleading by reason of any of the alleged omissions. Instead plaintiffs have chosen to assert vaguely that a false and misleading impression was created. The Court finds such a pleading to be insufficient.

The Court also determines that the identification of the alleged omissions is insufficient. Included in the Complaint are allegations that there was evidence of a significant number of septic abortions resulting from the use of the Shield and of deaths therefrom, that there was evidence that the multifilament tail of the Shield tended to increase the risk of infection during pregnancy when the Shield was in place, that there were substantial indications of serious health hazards arising from use of the Shield, and that there were numerous product liability cases instituted against Robins about which the shareholders were not informed until Robins issued an announcement in the 1974 annual report that as of March 18, 1975 there were 186 product liability suits pending against Robins.

Although the complainants are not required to plead their evidence, *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), there must be a sufficient basis for the defendants to determine what the plaintiffs are relying upon so that they may formulate a defense and answer the complaint. "At the very least, plaintiff[s] must disclose those facts that have led [them] to believe the defendants' publications are false." *Denny* v. *Barber*, 73 F.R.D. 6, 9 (1976).

The Court finds that the Complaint in this regard is no more particular than those in *Denny* v. *Barber*, *supra*, and *Tanzer* v. *Moore*, 76 Civ. 329 (S.D.N.Y. Oct. 4, 1977), which were dismissed for failing to meet the requirements of Rule 9. In both cases, the plaintiffs charged that the defendants had made speculative and risky loans without specifying any particular investment. In the present in-

stance, plaintiffs merely state that there was some "evidence" and "substantial indications" affecting the safety of the Dalkon Shield. It is not enough that there is some "evidence" since "the facts recited must be such as to permit an inference of fraud." *Denny* v. *Barber, supra,* at 9. Here, for example, no time frame is alleged with respect to the evidence which led the plaintiffs to suspect fraud. There is also no indication as to when the product liability cases were instituted or when the duty to announce them may be deemed to have been imposed. Absent this latter information, for example, it is not clear whether there might have been fraud since the product liability cases were allegedly disclosed in the 1974 Annual Report. Accordingly, the Court concludes that the allegations regarding omissions in the reports filed with the SEC must also be dismissed, although leave is granted to replead. The Court does not reach the question of whether there is an implied private cause of action for damages under section 10(b) because of alleged fraud in documents filed with the SEC.

The Court also concludes, based on the aforesaid reasons, that the portion of the Complaint alleging violations of common law principles should also be dismissed with leave to replead.

In addition, the Court finds that the Complaint fails to comport with the requirement of particularized pleading with respect to the individual defendants. These defendants are identified in the caption of the Complaint, and the initial paragraphs of the Complaint set forth the names and positions held by these defendants. The Complaint also asserts that each defendant either conspired to conceal the facts from the plaintiffs, or recklessly disregarded or failed to know that these facts were omitted from the various re-

ports. Each defendant is charged with participating in, or aiding or abetting in the alleged fraud. However, there is no indication of the role of any of the individual defendants in the preparation or dissemination of the reports. A Complaint alleging participation in fraud must state the relationship of the individual defendants to the alleged fraudulent documents. *Crane* v. *Stonehenge Industries, Inc.,* [1977-1978 Transfer Binder] CCH Fed.Sec.L.Rep. ¶96,103 (S.D.N.Y. 1977), *aff'd,* 77-7393 (2d Cir. Jan. 5, 1978); *Weinberger* v. *Kendrick,* [1976-1977 Transfer Binder] CCH Fed.Sec.L.Rep. ¶95,853 (S.D.N.Y. 1977).

The Court determines that the wholesale naming of seventeen directors and officers of the corporation does not satisfy the requirements of Rule 9 where their relationships to the documents is not alleged.

Conclusion

In summary, the Court hereby dismisses, pursuant to Fed.R.Civ.P. 12(b) (6), that portion of the Complaint alleging a manipulative device through the use of advertisements and patient brochures. The Court also dismisses the rest of the Complaint for failure to comply with Fed.R.Civ.P. 9(b), but plaintiffs are given leave to replead this portion of the Complaint within twenty days from the date of entry of this order.

So Ordered.

Dated: New York, New York
April 6, 1978

/s/ Lawrence W. Pierce
Lawrence W. Pierce
U. S. D. J.

APPENDIX D

Orders Denying Rehearing and Rehearing *In Banc*

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

79-7106

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighteenth day of December, one thousand nine hundred and seventy-nine.

Present: HON. WALTER R. MANSFIELD
HON. MURRAY I. GURFEIN
Circuit Judges
HON. JACOB MISHLER
District Judge

KALMAN ROSS and ANITA ROSS

Plaintiffs-Appellants,

v.

A. H. ROBINS COMPANY, INC., E. CLAIRBORNE ROBINS, WILLIAM I. ZIMMER, III, E. CLAIRBORNE ROBINS, JR., GEORGE E. THOMAS, KENNETH L. ROBERTS, CHARLES E. SALTZMAN and STUART SHUMATE,

Defendants-Appellees.

Appendix D—Orders Denying Rehearing and Rehearing In Banc

A petition for a rehearing having been filed herein by counsel for the appellees

Upon consideration thereof, it is

Ordered that said petition be and hereby is DENIED.

/s/ A. DANIEL FUSARO
A. DANIEL FUSARO, Clerk

Appendix D—Orders Denying Rehearing and Rehearing In Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

79-7106

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighteenth day of December, one thousand nine hundred and seventy-nine.

KALMAN ROSS and ANITA ROSS

Plaintiffs-Appellants,

v.

A. H. ROBINS COMPANY, INC., E. CLAIRBORNE ROBINS, WILLIAM I. ZIMMER, III, E. CLAIRBORNE ROBINS, JR., GEORGE E. THOMAS, KENNETH L. ROBERTS, CHARLES E. SALTZMAN and STUART SHUMATE,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellees, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

/s/ IRVING R. KAUFMAN
IRVING R. KAUFMAN
Chief Judge

APPENDIX E

Statutory Provisions

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1976)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 18 of the Securities Exchange Act of 1934, 15 U.S.C. § 78r (1976)

§ 78r. Liability for misleading statements

(a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

(b) Contribution

Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

(c) Period of limitations

No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

APPENDIX F

Respondents' Complaint

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

KALMAN ROSS and ANITA ROSS,

Plaintiff,

—against—

A. H. ROBINS COMPANY, INC., E. CLAIRBORNE ROBINS, WILLIAM I. ZIMMER, III, E. CLAIRBORNE ROBINS, JR., GEORGE E. THOMAS, KENNETH L. ROBERTS, CHARLES E. SALTZMAN, STUART SHUMATE,

Defendants.

AMENDED CLASS ACTION COMPLAINT
PLAINTIFFS DEMAND A TRIAL BY JURY

Plaintiffs, by their attorneys, allege upon information and belief, except for paragraph 2 hereof, which is alleged upon knowledge, as follows:

1. This action arises under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended, 15 U.S.C.A. Sections 78(a) *et seq.,* Rule 10b-5, 17 CFR 240-10b-5, promulgated thereunder and under common law principles. Jurisdiction is conferred upon this Court by Section 27 of the Exchange Act, 15 U.S.C.A. Section 78(aa), and the principle of pendent jurisdiction.

CLASS ACTION ALLEGATIONS

2. (A) Plaintiffs bring this action on behalf of the Class hereinbelow described, pursuant to Rule 23(b)(3) of the Federal Rules of Civil Procedure.

(B) The Class consists of all persons similarly situated who purchased the common stock of defendant A.H. Robins Company, Inc. ("Robins") from April 1972 through in or about July, 1974, the period of the wrongful conduct alleged hereinbelow and who still owned shares of Robins at the end of said period and who have suffered damages as a result thereof.

(C) There are thousands of persons who are members of the Class, located in various parts of the United States. As a result, joinder of all Class members is impracticable.

(D) Plaintiffs will fairly and adequately protect the interests of the Class inasmuch as they are members of the Class and their claims are typical of claims of all Class members. Plaintiffs interest is to obtain relief for themselves and for the Class for violations of law set forth herein.

(E) The common questions of law and fact include: (a) whether there has been a plan and scheme and common course of conduct to conceal from the public, material information concerning the true operating and financial condition and outlook of Robins, particularly with respect to matters concerning its intrauterine device, (commonly known as an "IUD"), the Dalkon Shield (b) whether defendants prepared and issued to the public during the relevant period, information which contained untrue statements of material facts and/or omitted to disclose all material facts relating to the foregoing; (c) whether defendants, by the

dissemination of misleading information and/or the omission to reveal material information, manipulated and inflated the price of Robins' stock; and (d) whether by such conduct the defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder are liable to plaintiffs and the class.

(F) The questions of fact and law that are common to the Class predominate over questions affecting only individual members.

(G) A class action is superior to other available methods for the fair and efficient adjudication of the controversy. It would be impractical and undesirable for each of the members of the Class who have suffered damage to bring separate actions, in various parts of the country; and, in addition, the bringing of such actions would put a substantial and unnecessary burden on the courts, while a single class action can determine the rights of all Class members with judicial economy.

SUBSTANTIVE ALLEGATIONS

COUNT I

3. Plaintiffs Kalman Ross and Anita Ross purchased 100 shares of the common stock of Robins on July 23, 1973, during the period in which the wrongs complained of herein were committed and continued. Plaintiffs continue to hold said shares to date.

4. Defendant Robins is a corporation organized and existing under the laws of the State of Virginia, and does business within the jurisdiction of this Court. It is principally engaged, directly and through its subsidiaries, in

the development, manufacture and distribution of ethical pharmaceutical products and brand name consumer products. Robins' products are distributed abroad and in the United States. As of December 31, 1976, it had $262,668,000 in total assets. Its stock is listed and traded on national securities exchanges, including the New York Stock Exchange. It has issued and outstanding approximately 26,126,928 common shares.

5. Defendant E. Clairborne Robins is, and at all times material hereto, has been Chairman of the Board of Directors of Robins.

6. Defendant William I. Zimmer, III, is a director of Robins and was at all times material hereto, the President and Chief Executive Officer of Robins.

7. Defendant E. Clairborne Robins, Jr., is, the President, Chief Executive officer and a director of Robins and was at all times material hereto, the Vice President and a director of Robins.

8. Defendant George E. Thomas is, and at all times material hereto, has been the Executive Vice President and a director of Robins.

9. Defendants E. Clairborne Robins, E. Clairborne Robins, Jr., Stuart Shumate and William L. Zimmer, III, and George E. Thomas are, and defendants Kenneth C. Roberts and Charles E. Saltzman were at all relevant times hereto, directors of Robins.

10. At all relevant times, the Board of Directors of Robins had the responsibility for the dissemination of information to the public, including the statements alleged in the reports referred to in the complaint as well as the information not dislosed to the public as further alleged in the complaint. The individual defendants, as directors of Robins, had the aforesaid responsibility as hereinafter alleged.

11. At all times material herein, and for most of its corporate history, Robins has been principally engaged in the development, manufacture and distribution of ethical pharmaceutical products, i.e., products dispensed for use by the public on prescription only, and secondly, in the development, manufacture and distribution of brand-name consumer products. Robins' principal ethical pharmaceutical products are drugs for cough and cold ailments, antispasmodic drugs used for gastro-intestinal disorders and skeletal muscle relaxants. While it has diversified into the manufacturing and marketing of brand-name consumer products such as Sergeants pet products, Chap-stick lip balm and Caron perfumes, worldwide sales of ethical pharmaceuticals remain its primary line of business. Sales of pharmaceutical products accounted for 67%, 73% and 74.4% of its net sales for 1976, 1975 and 1974 respectively, and 72%, 85% and 86% of its pre-tax profit for 1976, 1975 and 1974, respectively. Foreign sales of its products provided 33% of net sales in 1976.

12. Robins' sales, earnings, growth and overall prosperity are highly dependent upon its reputation as an ethical pharmaceutical manufacturer, which in turn depends upon the efficacy, reliability and safety of its products, upon the quality and integrity of its research and development procedures and its preclinical and post-clinical

testing procedures, upon advertising for its products and upon its record of compliance with applicable laws and regulations governing and regulating the development, testing, distribution and use of ethical pharmaceutical preparations. Moreover, the past and continuing prosperity of Robins, like that of other companies in its industry, depends to a marked degree upon belief in its scientific capability and integrity upon the efficacy, reliability and safety of its products on the part of physicians and other health care professionals who purchase, prescribe, and/or otherwise dispense or direct the dispensation of its products.

13. Since sometime in or about April 1972 and continuing in or about July, 1974, Robins and the individual defendants herein have engaged in a scheme and plan and continuous course of conduct to deceive the investing public, including plaintiffs, as to the true financial condition and prospects of Robins, particularly with respect to matters concerning the Dalkon Shield, and to conceal from the investing public, including plaintiffs, facts, among other things, concerning the safety and efficiency of the Dalkon Shield and the effect of such upon Robins operating and financial condition.

14. Prior to the commencement of the class period, Robins with approval of its Board of Directors which consisted of defendant Robins, Robins, Jr., Roberts, Saltzman and Shumate, prepared, issued and disseminated statements to the investing public highlighting developments with regard to the Dalkon Shield and publicizing its significant impact upon the business affairs of Robins. Said statements also stressed the safety, reliability and efficiency of the Dalkon Shield, particularly with regard to Robins' testing procedures and practices.

15. In Robin's 1970 Annual Report, issued in or about March 1971, it was stated:

> "In June we entered an entirely new product field for our company with the purchase of rights to the Dalkon Shield, an intrauterine contraceptive device (IUD) which was first introduced in late 1969. This is now being marketed to the medical profession through our field service representatives.
>
> "Although IUD's date back to ancient times and were mentioned in the writings of Hippocrates, recent improvements which have been made possible by modern technology have resulted in a resurgence of interest in these devices. At the end of 1969 it was estimated that some two million women in the United States, and more than eight million throughout the world, had been fitted with IUD's by their physicians.
>
> "Clinical tests indicate that the Dalkon Shield offers a low incidence of spontaneous expulsion, cramping and bleeding than other IUD's, as well as greater protection against pregnancy. We feel it has great promise, in the international as well as the domestic market, and have set up a special staff to introduce it widely in a number of areas overseas."

16. In Robin's 1971 Annual Report issued in or about March 1972, it was stated:

> "One of our most highly successful products during the year was the intrauterine contraceptive device, the Dalkon Shield, which was promoted during the year by our entire domestic detail force. The device is sold in the U.S. through surgical supply houses—a type of outlet new to our operations.

"We are also actively developing overseas markets for the Dalkon Shield, in more than a dozen countries. The device already has been purchased for distribution abroad by the International Planned Parenthood Federation, and also by the Pathfinder Fund, another organization which is interested in the field of family planning on an international basis."

17. In a prospectus issued in or about March 1972, it was stated with respect to the Dalkon Shield:

"In June, 1970, the company entered a new product field by purchasing the rights to the Dalkon Shield, an intrauterine contraceptive device which was first introduced commercially in late 1969. This product is marketed to the medical profession in the United States and Canada through the company's field representatives. It is also being introduced overseas. In 1971, the Dalkon Shield accounted for approximately 3% of net sales."

18. During the class period, Robins and the individual defendants knew or recklessly disregarded the fact that there were serious questions as to the safety and efficiency of the Dalkon Shield as evidenced by, among other things, the following facts all of which the said defendants knew or recklessly disregarded: (a) the actual pregnancy rate from the use of the Dalkon Shield was significantly higher than the low pregnancy rate Robins had indicated in the 1970 Annual Report as evidenced, among other things, by the fact that the rate of pregnancy from use of the Dalkon Shield had been found in an updated April 1972 unpublished study on the Shield by Mary Gabrielson to be 5.1% rather than 1.8% as reported in a published study by Ms. Gabrielson

approximately a year earlier; (b) that the rate of medical removals of the shield required by manifestations of pain, bleeding and infection was significantly higher than the low medical removal rate Robins had indicated in the 1970 Annual Report as evidenced, among other things, by the fact that the rate of medical removals for the shield required by manifestations of pain, bleeding and infection had been found in the aforementioned April 1972 unpublished study to be 26.4% rather than 14.9% as reported in the aforementioned earlier published study by Ms. Gabrielson; (c) that there were no studies conducted on the Dalkon Shield which involved more than 5.5 months of patient use, and thus there was insufficient clinical data to enable said defendants to reach scientifically valid conclusions concerning the pregnancy and/or medical removal rates for the shield; (f) that the Dalkon Shield was capable of and had caused septic abortions (badly infected miscarriages) in women who became pregnant with the Dalkon Shield in place, (g) that since 1972 there was a rapid and alarming increase in the rate of septic abortions from use of the shield, (h) that there had been at least 20 septic abortions by the end of 1972 and 200 by the end of 1973, (h) that the Dalkon Shield was capable of and had caused death from such septic abortions, (i) that since 1972 there was a rapid and alarming increase in the rate of deaths from septic abortions from use of the shield, (k) that at least 7 women had died from septic abortions in 1972 and 13 by the end of 1973, and (j) that there were other significant health hazards from use of the Dalkon Shield including a substantial number of reported cases of perforation of the uterus, pelvic inflammatory disease and ectopic pregnancy.

19. During the class period, Robins and the individual defendants also knew that public disclosure of the facts set

forth in paragraph 18 above, would materially affect Robins financial condition and operations, would jeopardize the prospects for the continuation of the Dalkon Shield's contribution to Robins' sales and earnings, would lead to an investigation by the U.S. Food and Drug Administration ("FDA") of Robins testing, reporting and other related practices and procedures bearing upon the safety and continued marketability of the Dalkon Shield, that there was a substantial probability that the Dalkon Shield would be withdrawn from the market or at least might be required to be distributed only under severe restricted conditions, would lead to potential enormous liability from products liability lawsuits for injuries from the Dalkon Shield seeking compensatory and punative damages, and that Robins standing and reputation as a developer and producer of reliable, effaceous and safe pharmaceutical products would be seriously undermined.

20. During the class period, in order to present a false and inflated picture of the operating and financial condition of Robins, all the defendants pursuant to a common plan and scheme and continuous course of conduct, concealed and failed to make proper and timely disclosure of the facts set forth in paragraph 18 above as well as the fact that in marketing and distributing the Dalkon Shield, Robins was incurring substantial risks to its reputation as aforesaid and substantial risks of substantial liability for injuries from use of the Dalkon Shield. In addition, defendants had a duty to disclose said information in order to correct the false and misleading impression created by the statements set forth in paragraphs 15 through 17 above that there were no facts known to the defendants indicating a

threat to the continued marketability of the Dalkon Shield and its continuing contribution to Robins sales and earnings, that the Dalkon Shield was effaceous, reliable and safe and was accepted by the medical and other health care professions as being so, that the Dalkon Shield would continue to increase its contributions to Robins earnings in the future and that the Dalkon Shield did not subject Robins to substantial liability for injuries from use of the shield.

21. While all the defendants during the class period were concealing and failing to disclose to the investing public the aforementioned information which showed the adverse impact upon Robins' operating and financial condition from the serious health hazards rising out of the utilization of the Dalkon Shield, at the same time, pursuant to a common plan and scheme and continuous course of conduct, the following misleading public statements about Robins and the Dalkon Shield were made and issued with the knowledge, approval and/or acquiescence of Robins' Board of Directors which consisted at all relevant times of the individual defendants.

22. In Robin's form 10-K for the fiscal year ending December 1972, issued in or about April 1973, it was stated:

> . . . "It [Robins] also holds a patent on the Dalkon Shield, an intrauterine contraceptive device.
>
> • • •
>
> . . . the drug industry for many years has been subject to scrutiny and regulations by the federal government . . . "Particular emphasis has been placed on safety, labeling, advertising and record keeping, and, more recently, on the effectiveness of drugs . . .

23. In Robins Form 10-K for fiscal year ended December 1973, issued in or about April, 1974, it was stated:

"The Company holds a patent on the Dalkon Shield, an intrauterine contraceptive device. . . ."

• • •

"The drug industry . . . for many years has been subject to scrutiny and regulation by the Federal Government, to an increasing extent by state governments and certain municipalities, and in varying degrees by federal governments. Particular emphasis has been placed on safety, labeling, advertising and record keeping, and more recently, on the effectiveness of drugs and certain economic aspects of the industry, as part of an effort to prove the quality and reduce the costs of drugs."

24. The aforesaid statements concerning the Dalkon Shield and Robins' emphasis upon the safety of its products including the Dalkon Shield, were misleading, as said defendants knew or recklessly ignored, in that (a) they failed to disclose the facts set forth in paragraph 18, (b) they further failed to disclose that in marketing and distributing the Dalkon Shield Robins was incurring substantial risks to its reputation as aforesaid and substantial risks of substantial liability for injuries from use of the shield, and (c) gave the false and misleading impression that there were no facts known to the defendants indicating a threat to the continued marketability of the Dalkon Shield and its continuing contribution to Robins sales and earnings, that the Dalkon Shield was effaceous, reliable and safe and was accepted by the medical and other health care professions as being so, that the Dalkon Shield would continue to increase its contributions to Robins earnings in the future

and that the Dalkon Shield did not subject Robins to substantial liability for injuries from use of the shield.

25. In a press release issued on or about April 19, 1973, Robins referred to the Annual Meeting of Robins stockholders in which defendant E. Clairborne Robins told the stockholders that sales and earnings for the past quarter of 1973 exceeded those for any previous quarter in the company's history and that "Mr. Robins attributed the record results primarily to the 'real strength' shown by the companies pharmaceuticals." The press release also stated:

"The stockholders were told that . . . among non-drug products, the Dalkon Shield has a large share of the market for intrauterine contraceptive devices."

26. The aforesaid statement was misleading as said defendants knew or recklessly ignored for the reasons set forth in paragraph 24 above and was further misleading in failing to disclose that such "large share of the market" for the Dalkon Shield and sales therefrom had been gained, in substantial part by fraudulent practices including the issuance of false and misleading advertisements to doctors and other health care professionals who prescribed the Dalkon Shield which included issuance of a November, 1972, advertisement which failed to include updated statistics from the aforementioned updated April 1972 unpublished study showing a pregnancy rate of 5.1% for the Dalkon Shield and a medical removal rate of 23.7% rather than the pregnancy rate of 1.8% and medical removal rate of 14.9% set forth in the advertisement.

27. In a press release dated July 18, 1973 it was stated:

"New highs for both sales and earnings were registered by A.H. Robins Company during the first half of 1973,

it was reported today by E. Clairborne Robins, Chairman of the Board and Chief Executive Officer of the Richmond-based pharmaceutical manufacturer . . . Mr. Robins attributed the gains in sales and earnings for the first half of 1973 to the continued strong showing of the company's pharmaceuticals."

28. In a press release dated January 31, 1974 it was stated:

"Unaudited figures indicate that A.H. Robins Company registered new highs for both sales and earnings for 1973, it was announced today by E. Clairborne Robins, Chairman of the Board and Chief Executive Officer of the Richmond-based pharmaceutical manufacturer . . . Mr. Robins said that continued strength in the company's pharmaceutical operations both in the U.S. and abroad was primarily responsible for 1973's record results."

29. The aforesaid statements were misleading as said defendants knew or recklessly ignored in that they failed to disclose the fact that said sales and earnings were based in part upon sales of the Dalkon Shield and that said sales of the Dalkon Shield involved a substantial risk that those sales would result in substantial liability for injuries caused by the Dalkon Shield and that the ability of Robins to continue selling the Dalkon Shield and to derive profits therefrom would be adversely effected by public disclosure of the facts set forth in paragraph 18 above.

30. In Robins' 1973 Annual Report issued in or about March, 1974, it was stated:

"We are greatly encouraged that the problems which presented themselves during the year just passed have in general been dealt with successfully.

31. The aforesaid statement was false and misleading as said defendants knew or recklessly ignored in that it failed to disclose that the problems concerning Robins' sale and distribution of the Dalkon Shield as indicated in paragraphs 18 and 19 had not and could not have been successfully dealt with and that said problems materially effected Robins' financial condition and operations.

32. In a press release dated April 18, 1974, it was stated:

"First quarter sales and earnings of A.H. Robins Company exceeded those for any previous quarter in the Company's history."

"It was announced that the Company's new manufacturing subsidiary in Puerto Rico is now almost fully staffed, and that the plant is expected to be producing . . . the Dalkon Shield by the third quarter of the year."

33. The aforesaid statements were misleading as said defendants knew or recklessly ignored in that they failed to disclose that the production of the Dalkon Shield and the sale thereof subjected Robins to enormous legal liability for injuries from use of the shield and that the ability of Robins to continue selling the Dalkon Shield which would be produced at said plant, would be adversely effected by the disclosure of the facts set forth in paragraph 18 above.

34. By letter dated May 8, 1974, but not mailed until the middle of the month, to approximately 120,000 physicians, (one-third) of the nation's physicians), Robins warned said physicians of severe complications resulting from use of

the Dalkon Shield including disclosure that thirty-six women who had used the Dalkon Shield had suffered septic spontaneous abortions in mid-pregnancy while the Dalkon Shield was in place and that four of them had died. Said letter urged the physicians to remove the Dalkon Shield immediately if the woman became pregnant, and if removal was not possible, to give serious consideration to offering the patient a therapeutic abortion, and further advised the physicians to test patients for pregnancy if they suspected that the devidce had failed. Robins did not announce, however, that it would cease to market the Dalkon Shield.

35. As a result of the aforesaid letter, the Planned Parenthood Federation of America instructed its 700 affiliated birth control clinics to cease prescribing the Dalkon Shield and to call in all patients using the Dalkon Shield and warn them of potential risks if they became pregnant.

36. As a result of the foregoing, the Food and Drug Administration announced an investigation and hearing into the safety and efficacy of the Dalkon Shield. Robins thereafter agreed to suspend sales of the Dalkon Shield within the United States pending further investigation by the FDA.

37. In July, 1974, the Department of Health, Education and Welfare (HEW) ordered all federally funded birth control clinics to cease prescribing the Dalkon Shield and suggested that physicians remove the device from any patient who came in for a routine checkup.

38. In December, 1974, the FDA announced that Robins could continue to market the Dalkon Shield, but only under carefully controlled conditions. Robins would be required

to limit distribution of the Dalkon Shield to physicians who agreed to keep a registry of each patient at the time of insertion and to keep detailed records of such patients' experiences with the device. In addition, the Dalkon Shield would be marketed under labelling approved by the FDA Robins also agreed, before it resumed marketing of the device, to replace the multifilament string of the Dalkon Shield with a monofilament string (non-woven material). The Planned Parenthood Federation of America continued its ban on the current shield and indicated that it did not plan to recommend the new Dalkon Shield.

39. In Robins' 1974 Annual Report, Robins announced that as of March 18, 1975, Robins had been named as defendant in 186 products liability cases alleging various injuries arising from the use of the Dalkon Shield and seeking punitive damages and compensating charges in the cumulative amount of approximately $180 million.

40. On August 11, 1974, Robins announced that although the new guidelines for marketing the new Dalkon Shield had not yet been announced by the FDA, it would not resume marketing of the new Dalkon Shield under any circumstances.

41. On or about April, 1976 Robins announced that it was a defendant in 533 cases arising out of injuries from use of the Dalkon Shield seeking punitive and compensatory damages in the cumulative amount of $480 million. To date, there are over 790 products liability cases pending against Robins.

42. At present, the publication of the matters hereinabove mentioned have impaired the market for the Dalkon

Shield outside of the United States, severely harmed Robins continued profits from its manufacture and distribution of the Dalkon Shield and has exposed Robins to enormous uninsured liability arising from said pending products liability cases.

43. Due to matters set forth hereinabove, Robins reputation and position in its industry have been jeopardized and its business prospects adversely affected. Robins has been further damages in that it will be required to revise and revamp its compliance practices and procedures, including its procedures for testing pharmaceuticals and for preserving, collecting and reporting upon data developed in such testing by its laboratories. As a result, it is reasonably anticipated that there will be a significant increase in its research and development costs as well as in its compliance costs, and that the profitability of its operation as a developer of new pharmaceuticals will be reduced in connection with complying with applicable legal requirements.

44. Each of the defendants named herein knew, or recklessly disregarded the facts set forth herein as well as the implications drawn therefrom and the consequences predictably flowing from the misconduct and concealments described herein; and said defendants knew, or recklessly disregarded the fact that the aforementioned public reports and press releases were materially misleading.

45. As a result of the disclosure of the above information concerning the Dalkon Shield alleged herein and the facts referred to in paragraphs 36 through 39 herein, the market price of Robins' stock dropped from approximately $19 to $13 per share on the New York Stock Exchange. By reason

of the foregoing, defendants manipulated and artificially inflated the market price of the commonstock of Robins during the period in question.

46. Plaintiffs and the members of the class made their purchases of Robins common stock at prices that were inflated by the foregoing misleading public reports and press releases and the representations contained therein and by defendants' failure to disclose the adverse matter hereinabove set forth.

47. During the period in question, plaintiffs and others similarly situated, in the absence of information disclosing the aforementioned adverse facts and their implications with respect to the Dalkon Shield and to the financial position and prospects of Robins during this period, and in reliance upon the aforementioned misleading public reports and press releases and upon the integrity of the market, bought stock of Robins. At the time they purchased their shares, plaintiffs and the other members of the class did not know and had no reason to believe that adverse matters had been omitted and otherwise not revealed. If plaintiffs and others similarly situated had known the true facts concerning Robins, they would not have purchased said stock at the prices they paid, or not all. At the times of the purchases by plaintiffs and others similarly situated of said stock, the fair market value of Robin's stock was substantially less than the prices paid by them.

48. As a result of the above-described acts and omissions of Robins and the individual defendants herein, they directly and indirectly, by use of the mails and means and instrumentalities of transportation and communication in interstate commerce, have violated Section 10(b) of the

Exchange Act and Rule 10b-5 promulgated thereunder, in that they (a) employed devices, schemes and artifices to defraud, (b) made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading, or (c) engaged in acts, practices and a course of business that operated as a fraud or deceit upon plaintiffs and others similarly situated in connection witth their purchases of Robins stock.

49. By reason of the wrongs described herein, plaintiffs and all others similarly situated have been damaged as a result of their purchases of Robins common stock.

50. Many of the acts and transactions hereinabove alleged occurred in whole or in part within the Southern District of New York.

COUNT II

51. Plaintiffs repeat and reallege each and every allegation contained in paragraphs 1 through 50 herein.

52. By reason of the foregoing, defendants have committed common law fraud upon plaintiffs and other members of the class and have violated their common law duties owed to plaintiff and the members of the said class.

WHEREFORE, plaintiffs pray for the following relief:

(A) That all defendants account to plaintiffs and all other members of the Class for the damages sustained by them, with interest;

(B) That all of the defendants be held liable for punative damages;

(C) That plaintiffs be allowed the costs and expenses of this action, including reasonable attorneys' and accountants' fees;

(D) That plaintiffs shall have such other and further relief as to the Court may seem just and proper in the premises.

Dated: New York, New York
May 18, 1978

WOLF POPPER ROSS WOLF & JONES

By /s/ ERIC L. KEISMAN
A Member of the Firm

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Supreme Court, U. S.
FILED
APR 12 1980
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1428

A.H. ROBINS COMPANY, INC., *et al.*,

Petitioners,

—against—

KALMAN ROSS and ANITA ROSS,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1428

A.H. ROBINS COMPANY, INC., *et al.*,

Petitioners,

—against—

KALMAN ROSS and ANITA ROSS,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

This brief is submitted on behalf of respondents in opposition to the petition, filed by petitioners who were defendants-appellees below, for a writ of certiorari to review the judgment and decision of the United States Court of Appeals for the Second Circuit entered on September 24, 1979.

That decision unanimously reversed the decision of the United States District Court for the Southern District of New York, which had held, among other things, that § 18 of the Securities Exchange Act of 1934 (the "Exchange Act") provided the exclusive remedy for that portion of respondents' claims relating to omissions and misrepresentations in documents of petitioner A.H. Robins Company, Inc. ("Robins") filed with the Securities and Exchange Commission ("SEC"), and thus they could not

form any components of a claim under § 10(b) of the Act.*

The Court of Appeals held that, at least in the context of an action where investors seek redress for damages arising out of an ongoing fraudulent course of conduct, elements of misconduct which might, in part, form the basis for a claim under § 18, could also constitute elements of a claim under § 10(b).

The District Court had also held that respondents' Amended Complaint (the "complaint") should be dismissed with prejudice for failure to plead fraud with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure ("FRCP"). The Court of Appeals held that respondents should be granted leave to replead, although it found the complaint insufficiently specific.

No other issues were decided by the Court of Appeals. Petitioners, in a vain effort to create the appearance of a conflict among circuits, argue that the Court of Appeals "dispensed with" reliance as an element of a § 10(b) claim, although no such issue was litigated below. The Court of Appeals "dispensed with" nothing. In illustrating the important differences between the elements of a § 10(b) claim and a § 18 claim, it simply noted, among other major differences, that certain presumptions of reliance are available in the litigation of a claim under § 10(b), while affirmative proof of direct reliance on a specific document must be alleged and proved to sustain a claim under § 18.

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* The Court of Appeals agreed with the District Court that respondents had set forth cognizable claims arising under § 10(b) and Rule 10b-5 promulgated thereunder with respect to petitioners' failure to disclose material information to the public and the numerous asserted omissions from and misrepresentations in a series of publicly disseminated documents of Robins, including Annual Reports to shareholders, press releases, and a prospectus which were not filed with the SEC.

The decision of the Court of Appeals creates no conflict with the decisions of any other court of appeals. It is not in conflict with the decisions of this Court, which has neither found it necessary nor appropriate to rule on the issues proffered by petitioners, while it has carefully delineated the proper scope of the established private right of action under § 10(b).*

A petition for rehearing with a suggestion for rehearing *in banc* was unanimously denied by the Court of Appeals. Respondents' consent to petitioners' motion for a stay of the issuance of the Court's mandate, pending application and disposition of the Petition for Certiorari, in no way indicated agreement that a question important enough to warrant consideration by this Court was at issue.

Questions Presented

Threshold questions, either of which if answered in the negative, are dispositive of the present petition, are:

1. Should this Court grant certiorari to consider any of the issues proffered by petitioners where, as here, there is no concrete case before this Court wherein there could be a determination of the legal rights of the parties upon a set of facts alleged; the complaint having been dismissed for failure of particularity, leave to amend having been granted by the Court of Appeals, and respondents having not yet filed a new amended complaint? Would not the review petitioners seek give rise to adjudication of abstract and hypothetical questions?

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* Neither the District Court nor the Court of Appeals considered or ruled upon the so-called "threshold" issue of whether a cause of action properly arises by implication under § 10(b) in favor of open-market purchasers of securities. In view of the virtually universal recognition of such claims by this Court and the courts of appeals (see p. 12, *infra*), there was no occasion to do so; and petitioners never raised the question below. It is therefore not properly raised here. *McCarthy* v. *E.E. Brunner,* 323 U.S. 673 (1944).

2. Should this Court grant certiorari to review the decision of the Court of Appeals which creates no conflict with any decision of this Court or other courts of appeals and which decided no significant unsettled questions of federal law?

The first question propounded by petitioners in wholly abstract form and not fairly presented by the record, would be better stated as follows:

3. (a) Is the right to maintain a private claim for relief for fraud under § 10(b) of the Exchange Act on behalf of purchasers of securities in the open market negated, where the market price of a company's securities is inflated by its broad public dissemination of favorable claims regarding its business and the prospects and success of a new product and where information belying those claims is concealed so that the total mix of information with respect to the company and its securities is fraudulently distorted, if some misleading information was also included in, or some matters concealed were also omitted from, documents filed with the SEC?

(b) In this context, is it not sufficient that such open market purchasers relied upon the total mix of information disseminated into the market in making their purchases and were thus defrauded in making purchases at an inflated market price, although they did not read, or thus directly rely on, filed documents in which material misinformation was also published, or from which material information was omitted?

Statement of the Case

The Dismissed Complaint

By virtue of its numerous omissions and mischaracterizations, the "Statement of the Case" in the Petition is materially misleading. For example, in an effort to cre-

ate the impression that respondents' claims fell squarely within the confines of § 18 in restating the complaint, it wholly distorts the thrust of the claim for relief sought to be pleaded.

The complaint alleged that respondents, Kalman and Anita Ross, purchased, in the open market, 100 shares of the common stock of petitioner Robins on July 23, 1973 and that, prior to and at the time of their purchase, the market in Robins' common stock was inflated by a fraudulent and deceptive course of conduct entered into by petitioners beginning in April 1972. (Appendix F-3, 6, 19)*

The complaint's actual thrust was accurately summarized by the Court of Appeals:

> "The gravamen of the complaint is that the defendants manipulated and artificially inflated the market price of Robins' common stock by disseminating false and misleading information about the effectiveness and safety of the Dalkon Shield, an intrauterine birth control device which it manufactured, and by failing to reveal information which indicated that the shield was more dangerous and less effective than the company's earlier public statements had indicated." (A-3).

That Court also correctly pointed out that, apart from the failure to disclose, respondents' claims arose out of a course of conduct including the dissemination of nine separate documents: Robins' 1970 Annual Report to shareholders; 1971 Annual Report to shareholders; March 1972 prospectus; 1972 Form 10-K; 1973 Form 10-K; press releases of April 19, 1973 and January 31, 1974; 1973 Annual Report to shareholders and press release of April 18, 1974.**

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* Citations to the Appendix refer to the Appendix to the Petition for Certiorari, and are hereafter styled, e.g., "(A-1)", "(B-1)" etc., referring to the section and page only.

** Contrast the purported summary of the complaint by petitioners, which seeks to create the false impression that Robins' Form

Respondents charged that, in the first three listed documents, Robins and the other defendants emphatically asserted, and disseminated to the public, claims of the scientific and business significance of an intrauterine contraceptive device manufactured by Robins, known as the Dalkon Shield, with boasts of intensive worldwide marketing, acceptance by major population control groups, and success in the market. (F-7, 8). But, beginning as early as April 1972, clinical information negating the original claims began to surface—some of it from the same research source that had initially supported those claims—along with news of serious contraindications, such as septic abortions and deaths in which the shield was implicated.

The complaint charged that petitioners completely failed to disclose this deleterious information to the public until May 1974; that they aggravated the situation by making additional (if muted) favorable statements in certain of the later documents; and that the market for Robins' common stock remained inflated by misinformation until that time. Further, it was alleged that, on partial disclosure, the market price of Robins stock precipitously dropped, to the damage of respondents and others who purchased during the period of concealment (i.e., the "class"). Alleging that the omissions and misstatements were knowing or reckless, that petitioners had a duty to disclose the concealed information, and that respondents and others similarly situated had purchased Robins' stock in reliance on "the integrity of the market" and in the absence of disclosure, the complaint asserted a claim under § 10(b) and Rule 10b-5. (See A-4-9).

10-K for 1972 was central to respondents' claims. (Petition, p. 5). Further it misdescribes the text of the allegations cited (F-11-12), as does the remainder of the purported summary of respondents' allegations. (Compare, Petition, p. 4-6 with Appendix, F. 7-15).

The Proceedings Below

A. *The District Court*

Petitioners moved to dismiss the complaint on the grounds that (1) the complaint alleged only a claim for corporate mismanagement and thus the court lacked subject matter jurisdiction; (2) the complaint failed to allege fraud with the particularity required by FRCP 9(b); and (3) the claims asserted could not be maintained under § 10(b) since § 18 provided the exclusive remedy for misstatements or omissions in documents filed with the SEC. (B-2).

The District Court decided that it did have subject matter jurisdiction in that the thrust of the complaint was fraud affecting the market in Robins' stock. It said that, to the extent that respondents had alleged omissions from, and mispresentations in, Robins' annual reports, a prospectus and press releases—documents not "filed" with the SEC—they had "generally stated a claim cognizable under § 10(b) and Rule 10b-5. . . ." (B-18). The court then held, however, that the complaint "lacks sufficient allegations . . . to determine whether plaintiffs have a proper claim under Section 10(b)," and therefore failed to comply with FRCP 9(b).

The basis for this holding was that respondents had failed to particularize "the time when the defendants allegedly knew or recklessly disregarded the undisclosed information." (B-9) As this holding applied to all of the "knowledge" allegations, whether dealing with filed or unfiled documents, the Rule 9(b) holding alone was dispositive. Nonetheless, the court went on to hold that, "the amended complaint in part, alleges facts which would support claims under Section 18 of the Act," and that, "since Section 18 provides the exclusive remedy available to private plaintiffs for acts or omissions which may be within the purview of that section, these plaintiffs cannot assert

claims under Section 10(b) which are based upon such acts or omissions." (B-11). The District Court granted the motion and, by opinion and order dated January 8, 1979, dismissed the action with prejudice. (B-19).

B. *The Court of Appeals*

The Court of Appeals, dealing with the issue of whether a claim which fell within the traditional contours of a § 10(b) action could include elements of omission or misrepresentation proscribed by § 18(a), concluded that "even as to those documents filed with the SEC, plaintiffs may seek to prosecute their claim under § 10(b) and Rule 10b-5." (A-24).

The Court of Appeals held that the District Court erred in dismissing the complaint, to the extent that it did so without leave to amend. In so holding, it agreed that respondents had insufficiently pleaded the necessary "circumstances which would give rise to an inference of fraud", with regard to petitioners' knowledge of the concealed adverse information; while acknowledging that the misrepresentations and omissions as such had been particularized. (A-27-A-29). Stating that it was "hesitant to preclude the prosecution of a possibly meritorious claim because of defects in the pleadings", the court reversed and remanded to allow repleading. (A-3; A-29).

In purporting to describe the Court of Appeals decision, the Petition (at p. 8-9) groundlessly claims that it created a new cause of action, misdescribes the premises of the decision, wrongly accuses the Court of Appeals of "dispensing with" various requisites of § 10(b), and accuses that Court of wrongful disregard of pertinent decisions of this Court calling for correction. Rather than clutter this counter-statement with inappropriate argumentation, these matters will be dealt with under "Reasons for Denying the Writ," *infra.*

Reasons for Denying the Writ

Certiorari should be denied in this case. The issues propounded for review cannot be determined on a concrete factual record, since there is indeed no factual record before this Court. Petitioners thus seek to obtain abstract and hypothetical rulings on amorphous questions. If any potentially significant questions of federal securities law may lie inchoate within the bounds of a case which may in the future be pleaded, such questions cannot fairly be said to arise from a determination dismissing a complaint with leave to replead. The opinion of the court of appeals is in harmony with the decisions of this Court. There is no holding in the decision below conflicting with any decision of this Court or any decision of any other court of appeals.

1. *There Is No Decision Below That Is Ripe for Review.*

The subsisting decision in this action is that the complaint has been dismissed, with leave to replead; a classic non-final determination, and one which leaves no factual record on which to base further review. This Court does not usually issue a writ of certiorari to review such a non-final determination, *American Construction Co.* v. *Jacksonville, T & K. W. R. Co.*, 148 U.S. 372 (1893); *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251 (1916); particularly where the Court of Appeals has remanded the cause for further proceedings. *Brotherhood of Locomotive Firemen and Enginemen* v. *Bangor & Aroostook R.R. Co.*, 389 U.S. 327 (1967).

This Court has been loath to grant certiorari to review important federal questions, upon a record inadequate to establish clearly the context and boundaries of the controversy to be determined. See *Ellis* v. *Dixon*, 349 U.S. 458 (1955), [writ dismissed as improvidently granted

where petitioners' complaint had been dismissed by the state court, and what "has been alleged is entirely too amorphous to permit adjudication of the constitutional issues asserted." (At 462)]; *Rescue Army, et al.* v. *Municipal Court of City of Los Angeles,* 331 U.S. 549, 568-570 (1947).

This reluctance to rule upon an inadequate record arises from the desire that determinations of such issues should take place in the context of a concrete factual setting, so as to avoid abstract, hypothetical or advisory determinations. The rendering of such determinations is inimical to the method by which a court finds and applies ruling principles of law—that is, in the context of deciding "a concrete case" determining "the legal rights of the parties in an adversary proceeding upon the facts alleged. . . ." *Aetna Life Insurance Co. of Hartford, Conn.* v. *Haworth,* 300 U.S. 227, 241 (1937). See also Tribe, *American Constitutional Law,* 53-62 (1978). Such opinions are considered as "advance expressions of legal judgment upon issues which remain unfocused. . . ." *United States* v. *Freuhauf,* 365 U.S. 146, 157-158 (1961) (per Frankfurter, J.).

Where the factual context calling for application and interpretation of a statute has not been fixed, the determination of such questions "involves too remote and abstract an inquiry for the proper exercise of the judicial function." *International Longshoremen's & Warehousemen's Union, Local 37* v. *Boyd,* 347 U.S. 222, 224 (1954).

The impropriety of review on this record is even more plain than in *Freuhauf, supra.* That this is so is manifest in the questions framed by petitioners. (Petition, 2-3). The first and third are stated in purely abstract terms. The second is wholly hypothetical, as well as a disingenuous mischaracterization of a complaint no longer existing in the litigation, since it has been dismissed with leave to replead.

Particularly where the bounds of a controversy remain inchoate, as where no complaint has either been finally sustained or finally dismissed, and there is no factual record, let alone an adequate one, certiorari is inappropriate. Petitioners cite several cases for the proposition that this Court has reviewed the outcome of a "pre-answer motion to dismiss", i.e., *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975); *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977); *Touche Ross & Co.* v. *Redington,* 99 S.Ct. 2479 (1979); *Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis,* 100 S.Ct. 242 (1979). (Petition, p. 9) But in each of those cases there had at least been a final determination by the Court of Appeals confirming the adequacy of the complaint so that a presumptive factual record was before this Court. See e.g., *Conley* v. *Gibson,* 355 U.S. 41 (1957).

Petitioners have not cited, and respondents have not found, any case where this Court has agreed to consider questions of federal law in the vacuum that arises where a Court of Appeals has found the complaint to be inadequate, and has remanded with leave to replead. In such a context, to resolve questions involving the interplay between § 10(b) and § 18 of the Exchange Act without knowing whether an amended pleading might in the future present such a question, is to consider a hypothetical issue in an abstract context, in violation of the well settled tenets promulgated by this Court for its exercise of certiorari jurisdiction.

2. *The Decision of the Court of Appeals Creates No Conflict With Any Decision of This Court, and It Decided No Significant Unsettled Question of Federal Law.*

In order to establish a conflict between the decision below and decisions of this Court or decisions of other Circuits, so as to justify review, there must be "a real conflict on the same matter of law or fact, not merely an inconsistency in dicta or in the general principles util-

ized." Stern & Gressman, *Supreme Court Practice,* 264 (5th Ed. 1978). See, *Layne and Bowler Corp.* v. *Western Well Works,* 261 U.S. 387, 392-393 (1923); *Keller* v. *Adams-Campbell Co.,* 264 U.S. 314 (1924); *Wisconsin Electric Co.* v. *Duxmore Co.,* 282 U.S. 813 (1929).

Petitioners erroneously contend that the Court of Appeals here created a new judicial remedy which is in conflict with the teachings of recent decisions of this Court; but petitioners read far too much into the very decisions they rely upon. In essence, they insist that the Court of Appeals should have pretended that it was writing on a clean slate, and should have commenced a *de novo* consideration whether Congress intended to create a private remedy under § 10(b).

The Court of Appeals created no new remedy. Rather, it reconfirmed the contours of the private claim for relief under § 10(b) held to be well-established by this Court; that is, a claim for relief against fraud, on behalf of purchasers or sellers of securities. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, at 194-198 (1976); *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, at 732-734, 745 (1975).*

In so doing, the Court adhered to the approach of this Court in *Blue Chip Stamps, supra,* in dealing with well settled legal doctrine. As the Court there said:

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* In fact, by the time this Court first dealt with the question, the existence of on implied right of action under § 10(b) was considered too well established to require discussion, in the light of the overwhelming existing consensus in the courts of appeals and district courts, *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 13, n.9 (1971); *Affiliated Ute Citizens of Utah* v. *United States,* 406 U.S. 128 (1972). That these rights were available to buyers as well as sellers had also, by then, been settled. E.g., *Jordan Bldg. Corp.* v. *Doyle, O'Conner & Co., Inc.,* 401 F.2d 47 (7th Cir. 1968); *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir., 1951); *Ellis* v. *Carter,* 291 F.2d 270 (9th Cir. 1961); *Doelle* v. *Ireco Chemicals,* 391 F.2d 6 (10th Cir. 1968); *Drake* v. *Thor Power Tool Co.,* 282 F. Supp. 94 (N.D. Ill. 1967).

> "We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the question. Given the peculiar blend of legislative, administrative, and judicial history which now surrounds Rule 10b-5, we believe that practical factors to which we have adverted, and to which other courts have referred, are entitled to a good deal of weight.
>
> Thus we conclude that what may be called considerations of policy, which we are free to weigh in deciding this case, are by no means entirely on one side of the scale." (421 U.S. at 749-750)

The Court of Appeals was also correct that the proper scope of the § 10(b) remedy was not illuminated by *Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis,* 100 S.Ct. 242 (1979) or *Touche Ross & Co.* v. *Redington,* 99 S.Ct. 2479 (1979), which dealt with whether *new* implied remedies should be recognized under relatively obscure statutes; and neither its decision or reasoning was in conflict with those recent cases.

In *Touche Ross, supra,* the Court held, upon its first consideration of the question, that no private claim for relief legitimately arose by implication from § 17(a) of the Exchange Act, which "simply requires broker-dealers and others to keep such records and file such reports as the Commission may prescribe," and which, unlike the statutes under which an implied right had been sustained, neither "prohibited certain conduct" nor "created federal rights in favor of private parties" (At 2485). This was the dispositive holding of *Touche Ross.* The Court's comment that "[t]here is evidence to support the view that § 18(a) was intended to provide the exclusive remedy for misstatements contained in any reports filed with the Commission", lends no support to the petitioners' position since the

Court there was only dealing with the interplay between § 18 and § 17(a) of the Exchange Act and not with § 10(b).

Nor is there conflict with this Court's decision in *Transamerica Mortgage Advisors, Inc., supra,* where this Court recognized an equitable private right of action under § 215 of the Investment Advisers Act of 1940, and declined to imply a private claim for damages under § 206 of that Act. The Court pointed to the absence from the Advisers Act of any express private civil liability provisions, and the absence of an explicit grant of federal jurisdiction over actions at law as factors which called for a narrower reading of this statute than had been given to those under which private damage suits had been found proper. This has no bearing on interpretation of the Exchange Act.

There is *a fortiori* no conflict with *Cannon* v. *University of Chicago,* 441 U.S. 677 (1979), wherein this Court allowed a new implied private right of action under § 901 of Title IX of the Education Amendments of 1972, 20 U.S.C. § 1681. The Court there concluded that all of the criteria set out in *Cort* v. *Ash,* 422 U.S. 66 (1975) for implication of a private right of action, even a new one, were present although there was evidence in the legislative history that express provision of such a remedy had been urged in debate, but not adopted. While there was an indication that the Court employed a stricter analysis in *Cannon* than it had in the earlier cases arising under the federal securities laws, the Court made clear that it continued to recognize the historical legitimacy of the latter.

Far from being novel, the decision of the Court of Appeals in this respect was wholly in harmony, not only with the expressions of this Court, but with the seminal court of appeals decision considering the question, *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951). In essence, the *Fischman* court, and the Court of Appeals here, properly understood that the right and remedy provided by § 10(b) differ in kind, and not merely in degree,

from that provided by § 18, or § 11 of the Securities Act of 1933. The distinction is that § 10(b) offers relief only where the action is predicated upon fraud. Section 18, like § 11, has no requirement that plaintiff plead or prove any wrongful intention on the part of the defendant. It was because of this lack of a requirement of proof of wrongful intent that Congress surrounded the § 18 remedy, like the § 11 remedy, with procedural and substantive constraints.* The fear of unjustified imposition of liability, expressed in the portions of the legislative history referred to by petitioners, was expressed in debate as to the scope of a remedy for non-fraudulent conduct, or "mistake." (See, Petition, 17)

Section 10(b), as the Court of Appeals explained here and in *Fischman,* retains the contours of the common law action for fraud; and thus does not give rise to the prospect of unfairly imposing liability upon a defendant who promulgated misleading information without the intent to commit any wrong. Further, the close relationship, between § 17 and § 18 of the 1934 Act is not duplicated in § 18's relation to § 10(b). As the Court of Appeals properly observed, it was clearly the expectation of Congress that the establishment of the SEC, and the requirement that corporate reports be filed with it, would in and of itself, not only encourage the filing of truthful reports, but would encourage investors to rely specifically upon those filed reports. (A-23) Accordingly, there was ample reason to provide a special, non-fraud, remedy for false and misleading filings.

There simply is no such schematic interplay between § 18 and § 10(b). Whereas § 18 focuses narrowly on the

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* Congress was wholly aware of the significance of this allocation of the burden of proof. A vigorous effort was made on the House floor to amend Section 18 to require a plaintiff to prove wrongful intent, and thus to convert it into a fraud-type statute. See 78 Cong. Rec. pp. 8038-8040. The charge was made that without the amendment, the defendant became an insurer. The amendment was rejected, *Ibid.*

isolated act of filing a misleading document with the SEC, only § 10(b) broadly prohibits "any manipulative or deceptive device or contrivance", including, as set out in Rule 10b-5(c) "any . . . practice or course of conduct which operates . . . as a fraud. . . ." Section 10(b) is thus the only section of the Exchange Act which deals with a fraudulent ongoing course of conduct. Since nothing in the decision of the Court of Appeals changed any existing law, created or altered any existing remedy, or determined any actual controversy, there is no occasion for this Court to consider, in this context, the relationship, if any, between § 10(b) and § 18.

Further, the Court of Appeals was correct in considering the consequences that would eventuate were it to disturb the scope of an existing, long recognized, private claim for relief. It correctly described the consequences of accepting petitioners' contentions, that is, that it would eliminate from the law the protection for open market investors which has become "the primary mechanism[s] by which" they could obtain "redress against those who manipulate the market by fraudulent activity." (A-24).

In *Blue Chip Stamps* this Court aptly described the reality that required such a conclusion:

> "In today's universe of transactions governed by the 1934 Act, privity of dealing or even personal contact between potential defendant and potential plaintiff is the exception and not the rule. The stock of issuers is listed on financial exchanges utilized by tens of millions of investors, and corporate representations reach a potential audience encompassing not only the diligent few who peruse filed corporate reports or the sizeable number of subscribers to financial journals, but the readership of the Nation's daily newspapers. Obviously neither the fact that issuers or other potential defendants under Rule 10b-5 reach a large number of potential investors, or the fact that they are required by law to make their disclosures conform to certain standards, should in any way absolve them from liability for misconduct which is proscribed by Rule 10b-5." (421 U.S. at 745)

As the decision in the Court of Appeals creates no conflict with the decisions of this Court, and decided no significant unsettled questions of federal law, there is no reason to review it.

3. *There Is No Conflict With the Decisions of Other Circuits in the Decision Below; Nor Does It Raise Any Unsettled Question as to the Law of Causation or Reliance.*

Petitioners, seeking to posit a conflict among decisions of the circuits, where none exists, accuse the Court of Appeals here of "dispensing with" the reliance requirement of § 10(b). This is a false issue. Neither the Court of Appeals nor the District Court had any occasion to actually pass upon the question whether, or to what extent, reliance or causation-in-fact, or both, were affirmative elements of respondents' case.

Emboldened by the lack of either a subsisting pleading or a factual record, petitioners misstate the position taken by respondents when they claim that respondents "admitted they 'did not read or see, much less actually rely upon' the statements of which they complained. . . ." (Petition, 25). What respondents in fact said, as revealed earlier in the Petition itself (at p. 6) was that they did not read, see or actually rely upon "filed" documents. Respondents did, in fact, assert reliance and causation in fact. They said that they, "and others similarly situated," purchased their Robins shares "in reliance upon the aforementioned misleading public reports and press releases and upon the integrity of the market. . . ." (Complaint, ¶ 47; F-19).

Had this complaint survived, there would be no question but that plaintiffs would seek to prove, as to themselves, reliance upon the total mix of information made available, in the absence of disclosure of material adverse information. The cited statement in their brief to the Court of Appeals merely emphasized that they did not personally claim direct reliance on either of the two Forms 10-K referred to in their pleading. As this Court recognized in *Blue Chip Stamps, supra,* at 745, this is typical of the large class of investors who receive their information indirectly, through public media, with respect to securities they consider purchasing, and not through actual examination of "filed corporate reports". Respondents, in short, never suggested or argued that they could recover without a showing that their reliance on the integrity of the market in fact caused their purchases and that their loss was caused by defendants' conduct. Such causation in fact is, of course, the settled law of the Second Circuit. See *Schlick* v. *Penn-Dixie Cement Co.,* 507 F.2d 374 (2d Cir. 1974). This Court, in *Blue Chip Stamps, supra,* made plain its view that such indirect transmission of information to the general run of investors should not "absolve . . . from liability" under Rule 10b-5, those who disseminate misinformation, or who fail to disclose material information to the public. 421 U.S. at 745.

Thus, even if this Court had before it for review, a concrete case of the character actually sought to be litigated by respondents here (which it does not), it is clear that the issue proposed by petitioners simply would not exist. There is no reason for considering the hypothetical question.

The comment by the Court of Appeals, in explaining the importance of certain differences between the direct reliance requirement apparently established by § 18 and the comparatively attentuated reliance—causation in fact

requirements imposed under varying circumstances under § 10(b), was neither a holding, nor, *a fortiori,* a decision which created a conflict with any other appellate decision. (A-15) It did not rest its opinion that the two sections are not mutually exclusive, under the circumstances presented, upon that distinction. Rather, the crucial distinction which the Court of Appeals saw was the difference first recognized in *Fischman, supra,* which pointed out that, to establish a § 10(b) violation, a plaintiff must plead and prove *scienter,* and thus, in effect, fraud; while, under § 18, the plaintiff must merely "plead and prove" a material misstatement or omission in a document filed with the Commission, leaving it to the defendant to raise and prove the defense of good faith and the absence of knowledge. (A-22)

The Court's expression of the distinction between the § 18 and § 10(b) standards regarding these elements is not in conflict with any other appellate decision. The Court of Appeals here was clearly referring to an open market situation where this misinformation, or omission, had affected the total mix of information available to investors. The four cases relied on by petitioners are not to the contrary.

In *Landy* v. *FDIC,* 486 F.2d 139 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974), the Court dismissed for lack of a showing of reliance only with respect to reports of a defendant accountant that had not been prepared for or disseminated to the public or the subject company's stockholders. Under these circumstances it said that "the presumption of reliance sometimes used in other circumstances when a statement is material is inapplicable here. . . ." and noted that such a presumption might indeed apply to annual reports issued by the subject corporation. (486 F.2d at 170)

Dupuy v. *Dupuy,* 551 F.2d 1005 (5th Cir. 1977), *cert. denied,* 434 U.S. 911 (1977), and *Holdsworth* v. *Strong,* 545

F.2d 687 (10th Cir. 1976), *cert. denied,* 430 U.S. 955 (1977), are even further from the point. ~~In each~~, the plaintiff had asserted as the principal basis for relief, affirmative misrepresentations made in *face to face* transactions, involving the sale by plaintiffs to defendants of the stock in *close corporations.* Where the allegedly defrauded seller is himself an insider, and thus in at least a good position as defendants to obtain accurate information directly, there is no parallel to the situation of the ordinary investor in the public corporation, who generally relies upon information received at second hand, from public media of communication. In the close corporation—insider sale context, it is clear that the Second Circuit is in accord with these decisions. See, e.g., *Schlick* v. *Penn-Dixie Cement Corp., supra,* cf. *Jackson* v. *Oppenheim,* 533 F.2d 826 (2d Cir. 1976).

Finally, there is no conflict between the decision below and *Vervaecke* v. *Chiles, Heider & Co., Inc.,* 578 F.2d 713 (8th Cir. 1978). There, the Court emphasized that plaintiff had actually asserted that he was personally misled by, and caused to buy the securities at issue by, the contents of an offering prospectus. Later, in his deposition, he admitted that, while the offering statement had been mailed to him, he could not recall that he had read it before he purchased the securities. Further, he could not recall whether he read the offering statement sent to him by the broker whom he had chosen to sue. Thus, the Eighth Circuit affirmed the grant of summary judgment below, on the grounds that there was no proof that there was any causal connection between plaintiff's receipt of an offering statement from defendant and his loss. (578 F.2d at 718-719). The Court, at the same time, made plain that, under more appropriate circumstances, it would follow the "less stringent test of causation" in non-disclosure cases, in accord with the doctrine of *Affiliated Ute Citizens* v. *United States, supra.*

Thus, the Court of Appeals' illustrative comments upon the state of the law of reliance in open market cases raises no conflict of authority; nor does it create an unsettled question of importance in the federal law of securities.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit should be denied.

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1428

A. H. ROBINS COMPANY, INC., *et al.*,

Petitioners,

v.

KALMAN ROSS and ANITA ROSS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

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April 15, 1980

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IN THE

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

1. Respondents say to this Court that the decision below "decided no significant unsettled questions of law" (R. Br.p. 4).

Respondents said to the court of appeals, however, that their appeal raised "a matter of first impression" and "a significant issue of first impression." They said:

> "This appeal raises important and serious issues, including one issue that is a matter of first impression before any court of appeals. The decision of this appeal will have impact beyond the case at bar, and upon almost every other case filed in this Circuit and elsewhere arising under the Securities Exchange Act of 1934 ("Exchange Act"), particularly Section 10(b) and Rule 10b-5."

In discussing the court of appeals decision, counsel for respondents has recently recognized with respect to the first question presented by the Petition that the answer:

> "remains in doubt, and may so remain for some time, unless the Supreme Court should review one of these cases. Needless to say, the answer to this question will have great significance to the securities bar." *

In the court of appeals, the SEC requested permission to file out of time a brief as *amicus curiae* because "important federal securities law issues" were involved. Respondents do not refer to this fact or to the motions of the American Institute of Certified Public Accountants and five national broker-dealers to file briefs as *amici curiae* in support of the Petition.

2. The first question presented by the Petition was posed by this Court. The second question assumes *arguendo* an "implied" §10(b) remedy and addresses an issue as to which there is a direct conflict between the decision below and the decisions of four other courts of appeals. The third question addresses Congressional intent ignored by the court of appeals, but which this Court has held to be determinative.

In *Kissinger* v. *Reporters Committee for Freedom of the Press*, 100 S.Ct. 960 (1980), this Court stated:

> "This Court has spent too many pages identifying the factors relevant to uncovering congressional intent to imply a private cause of action to belabor the topic

* Keisman, *Actions Under Various Securities Law Provisions—A Review of Express and Implied Remedies*, The Investor and the Corporation: New Developments and Tactics in Stockholder Litigation 101 (PLI April 1980).

> here.[4] Our most recent pronouncement on the subject, *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, —— U.S. ——, 100 S.Ct. 242, 62 L.Ed.2d 146 (1979), readily disposes of the question.
>
> [4] *See Touche Ross* v. *Redington*, —— U.S. ——, 99 S.Ct. 2479, 61 L.Ed.2d 82 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677, 99 S.Ct. 1946, 60 L.Ed.2d 560 (1979)."
> (100 S.Ct. at 967-68)

In contrast, the court of appeals termed *Cannon* and *Redington* "inapposite" and not "particularly instructive" (A-16, 17), and in denying rehearing ignored *Transamerica Mortgage Advisors.**

3. Last week the General Counsel of the Securities and Exchange Commission presented a paper entitled "SEC and Private Remedies for Securities Law Violations" at a symposium sponsored by the American Law Institute and the American Bar Association concerning important recent developments in the federal securities laws. He discussed this Court's recent decisions and noted "[a] question that has arisen is whether an action for damages can be brought [under §10(b) and Rule 10b-5] even though the alleged material misstatements are also actionable under Section 18", that this question was raised but not resolved in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 211 n.31 (1976), and

* Other courts of appeals, unlike the court below, have understood this Court's teaching that legislative intent is determinative of when a private damage cause of action may be inferred from a statute not providing one. *See Jablon* v. *Dean Witter & Company*, [Current] CCH Fed.Sec.L.Rep. ¶97,296 at 97,032 (9th Cir. 1980) (refusing to imply a private damage remedy under NYSE Rule 405 or the NASD suitability rule); *Rogers* v. *Frito-Lay, Inc.*, 611 F.2d 1074, 1078, 1085 (5th Cir. 1980) (refusing to imply a private damage remedy under the Rehabilitation Act); *Taylor* v. *Brighton Corporation*, No. 77-3590 Slip Op. at 5-6, 13 (6th Cir. February 14, 1980) (refusing to imply a private damage remedy under the Occupational Safety and Health Act).

that in *Redington* "without resolving the issue, the Court noted that there is evidence to support the proposition that Section 18(a) was intended to provide the exclusive remedy for misstatements in reports filed with the SEC." He contrasted the decision below with other authorities cited at page 11 n.* of the Petition, including *McFarland* v. *Memorex Corporation,* No. C-79-2007 (N.D. Cal. February 12, 1980), which he stated "overrules Ninth Circuit authority (*Ellis* v. *Carter,* 291 F.2d 270 (9th Cir. 1961))." *

At this same symposium, the immediately past General Counsel of the SEC presented a paper entitled "Judicial Developments in Civil Liabilities Under the Federal Securities Laws".** He characterized the decision below as "surprising" and as expressing a "rather cavalier attitude" toward the numerous difficult problems created by the interplay of express remedies and judicially "implied" remedies, and as articulating a "surely troublesome" test for judicial implication for which the court of appeals "understandably cites no authority". He concluded:

> "One cannot help considering the 'music' of the Supreme Court's recent decisions, and particularly its suggestion that Section 10(b) was intended to play a supplemental, rather than a primary, role in the regulation

* Respondents rely (R.Br.p. 12n.*) upon *Ellis* and a number of cases which are premised upon *Ellis*. We agree with the General Counsel of the SEC that *Ellis* is no longer good law in light of recent decisions of this Court. In *Ellis* the court of appeals assumed "that Congress in 1934 undid what it carefully did in 1933" (291 F.2d at 274). Of course, this Court has found directly to the contrary. *Hochfelder,* 425 U.S. at 208-11. *A fortiori,* it can no longer be maintained that Congress intended to "undo" by implication "what it carefully did" expressly within the same Act.

** In *Cannon,* this Court cited approvingly an earlier article on "implied" rights of action by the same author, stating that "[t]he Court's decidedly different approach since 1972 to cause of action by implication has not gone without scholarly notice" (441 U.S. at 698 n.24).

> of the securities markets (*Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 203 (1976)), and wonder whether the *Ross* decision reflects a faithful application of the policies the Supreme Court has been articulating over the last four years."

4. Respondents assert (R.Br.p. 3) that there is "no concrete case for this Court."

The author of the district court decision here has, however, been constrained by the decision of the court of appeals to deny a motion to dismiss which was in substance the same motion he had granted when made by petitioners. *Abrams* v. *Johns-Manville Corporation,* [Current] CCH Fed.Sec.L. Rep. ¶ 97,305 (S.D.N.Y. 1980).

This decision, most vividly, and what respondents and the SEC said to the court of appeals about the issues presented here deny respondents' assertion to this Court.

5. Respondents also assert (R.Br.pp. 2, 17-21) that the court of appeals did not "dispense with" the requirement of reliance as an element of a § 10(b) claim or decide any issue of causation.

The court of appeals did so expressly and in just those words (A-23) and lower courts have so read the court of appeals' decision. *See Panzirer* v. *Wolf,* [Current] CCH Fed.Sec.L.Rep. ¶ 97,251 at 96,766 (S.D.N.Y. 1980).

The court of appeals premised its decision upon an expansive and clearly erroneous reading of *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972). On March 18, 1980, four days after this Petition was filed, this Court delineated the appropriate reach of *Affiliated Ute Citizens* as based upon a "duty to disclose arising from a relationship of trust and confidence". *Chiarella* v. *United States,* 48 U.S.L.W. 4250, 4252 (U.S. March 18, 1980) (reversing

the court below). The reading given *Affiliated Ute Citizens* by this Court in *Chiarella,* is that suggested in this Petition (Pet.p. 13). A writ of certiorari should issue on the second question presented since the decision below, in its interpretation of *Affiliated Ute Citizens,* conflicts with the more recent teaching of this Court as well as the holdings of other courts of appeals.

6. Respondents assert (R.Br.p. 3n.*) that "[n]either the District Court nor the Court of Appeals considered or ruled upon" the question whether Congress intended to create a private damage cause of action in favor of open-market purchasers for violations of § 10(b).

This question, of course, underlies the decision of the court of appeals that respondents "may seek to prosecute their claim under § 10(b) and Rule 10b-5" (A-24).* In point of fact, moreover, petitioners pointed out to the court of appeals this Court's limitations beginning with *Amtrak,* 414 U.S. 453 (1974), upon the "implication" of private rights of action and (in the petition for rehearing) that the court of appeals had judicially created a private damage action not intended by Congress.

7. Respondents argue (R.Br.p. 9) that this Court does not issue writs of certiorari in cases which do not have a "factual record on which to base further review."

There are no "factual" issues which need be developed here. Leave to file an amended complaint does not permit respondents to allege the reliance they have so categorically disclaimed. The questions presented are pure questions of law addressed to the complaint. They are like the questions presented in *Transamerica Mortgage Advisors, Redington, Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977),

* *Vance* v. *Terrazas,* 100 S.Ct. 540, 544 n.5 (1980).

Hochfelder, United Housing Foundation v. *Forman,* 421 U.S. 837 (1975), and *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), where this Court granted certiorari to resolve important questions of federal law which were present although the judgments reviewed were not final.

Respondents rely (R.Br.p. 9) upon decisions involving the dissimilar situations of the issuance or denial of preliminary injunctions and of interlocutory remand to the district court for findings of fact necessary for appellate review. Their description of such decisions is lifted out of context from R. Stern & E. Gressman, *Supreme Court Practice* § 4.19 at 300 (5th ed. 1978). Stern and Gressman recognize in the immediately following page that where:

> "there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status." (*Id.* at 301)

In support of this proposition, entirely applicable here, the authors cite: *Gillespie* v. *United States Steel Corp.,* 379 U.S. 148, 153-54 (1964); *United States* v. *General Motors Corp.,* 323 U.S. 373, 377 (1945); *Land* v. *Dollar,* 330 U.S. 731, 734 n.2 (1947); *Larson* v. *Domestic & Foreign Commerce Corp.,* 337 U.S. 682, 685 n.3 (1949); *Hanover Star Milling Co.* v. *Metcalf,* 240 U.S. 403, 408-09 (1916); *Forsyth* v. *Hammond,* 166 U.S. 506, 514-15 (1897); *American Construction Co.* v. *Jacksonville, T. & R.R. Co.,* 148 U.S. 372, 387-88 (1893).

Respondents' reliance (R.Br.p. 10) upon cases involving "advisory opinions", *United States* v. *Freuhauf,* 365 U.S. 146 (1961), *Aetna Life Insurance Co.* v. *Haworth,* 300 U.S. 227 (1937), or "ripeness" or "justiciability" in the context

of a constitutional challenge, *International Longshoremen's and Warehousemen's Union, Local 37* v. *Boyd,* 347 U.S. 222 (1954), *Rescue Army* v. *Municipal Court of City of Los Angeles,* 331 U.S. 549 (1947), is misplaced. Respondents take these citations from L. Tribe, *American Constitutional Law* 53-62 (1978), where the author discusses federal judicial power in the context of constitutional questions. However:

> "As long as the jurisdiction of the court of appeals has properly been invoked and a timely petition for certiorari filed, the Supreme Court has jurisdiction to take the case whatever its status in the lower courts. *The Conqueror,* 166 U.S. 110, 113." R. Stern & E. Gressman, *Supreme Court Practice* § 2.2 at 53 (5th ed. 1978).

Respondents, again parrotting from Tribe's discussion of justiciability, *supra,* at 58, characterize the questions presented as "abstract" and "hypothetical". They are not. The questions presented raise important and clear-cut issues of law that are fundamental to the further conduct of the case. The only "factual record" (R.Br.p. 9) necessary to a determination of the questions presented is the amended complaint (Appendix F to the Petition) and the law. The court of appeals described the former, but ignored the latter.

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On seven occasions since 1975 this Court has reversed or overruled the court of appeals for the Second Circuit in cases arising under the federal securities laws.* In this

* *Chiarella, Transamerica Mortgage Advisors* (overruling *Abrahamson* v. *Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978)), *Redington, Burks* v. *Lasker,* 441 U.S. 471 (1979); *Sante Fe Industries, Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977); *United Housing Foundation.*

case the court of appeals again determined to chart its own course, choosing to characterize decisions of this Court as "inapposite" or not "particularly instructive" or by ignoring them altogether. The decision below demands review by this Court.

CONCLUSION

The writ of certiorari should issue.

Respectfully submitted,

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April 15, 1980

APPENDIX

79-7106

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twenty-sixth day of March, one thousand nine hundred and eighty.

KALMAN ROSS and ANITA ROSS,

Plaintiffs-Appellants,

v.

A.H. ROBINS COMPANY, INC., E. CLAIRBORNE ROBINS, WILLIAM I. ZIMMER, III, E. CLAIRBORNE ROBINS, JR., GEORGE E. THOMAS, KENNETH L. ROBERTS, CHARLES E. SALTZMAN and STUART SHUMATE,

Defendants-Appellees.

It is hereby ordered that the motion made herein by counsel for the appellees by notice of motion filed December 21, 1979 to stay issuance of the mandate pending application to the Supreme Court of the United States for a writ of certiorari pursuant to Rule 41(b) F.R.A.P. be and it hereby is granted.

/s/ WALTER R. MANSFIELD
Walter R. Mansfield, U.S.C.J.

/s/ JACOB MISHLER
Jacob Mishler, U.S.D.J. (per WRM)

Circuit Judges

MOTION FILED
MAR 17 1980

IN THE

Supreme Court of the United States

October Term, 1979

No. 79-1428

A. H. ROBINS COMPANY, INC., *et al.*,
Petitioners,

vs.

KALMAN ROSS and ANITA ROSS,
Respondents.

MOTION OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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The American Institute of Certified Public Accountants (the "Institute") hereby respectfully moves, pursuant to Rule 42(3) of the Rules of this Court, for leave to file the attached brief *amicus curiae* in support of the Petition for a Writ of Certiorari in the above captioned case.[1] The Institute is the only national accounting association whose membership is limited to certified public accountants; it has approximately 155,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in pursuit of that purpose, the Institute has come to be accepted as the authoritative source of standards and procedures in its field. Most particularly, the Institute develops Generally

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[1] Petitioners have consented to the filing of this brief. Respondents' consent has been requested but refused.

Accepted Auditing Standards which form the standard of professional conduct for independent public accountants associated with financial statements, including those filed with the Securities and Exchange Commission.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed with respect to documents filed with the SEC. The Institute was invited to and did present its views before the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act (*Hearings on S. Res. 84 (72nd Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate,* 73rd Cong., 1st Sess., pt. 15 at 7027-10 (1934)) and, more recently, was accorded permission by this Court to file briefs *amicus curiae* in *Touche Ross & Co.* v. *Redington,* ——U.S.——, 99 S. Ct. 2479 (1979) and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). In light of that interest, the Institute will confine its brief *amicus curiae* to the issue of major significance to the accounting profession as a whole that is presented by a combination of the three questions tendered in the Petition for Certiorari. That issue may, for present purposes, be cast as follows:[2]

> May civil liability for misleading statements in documents filed with the SEC be judicially implied under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(a) (the "1934 Act") in favor of open market purchasers and sellers of securities beyond that provided by Congress in Section 18 of the 1934 Act, 15 U.S.C. Section 78r, when the plaintiff did not rely on such documents?

[2] The Institute does not express any position with respect to any other issue that may be subsumed in the issues presented by petitioners.

The court below answered this question in the affirmative. That decision, if upheld, imposes potentially unsupportable risks upon the performance of the audit function. The holding below sanctions a "market impact" theory of liability under Section 10(b) and would allow purchasers and sellers of securities to invoke a private cause of action created under Section 10(b) without even having seen, much less relied upon, the documents claimed to be misleading. The implications of the unsatisfactory analysis upon which that holding was reached transcend the interests of the parties litigant and are of disturbing significance to the accounting profession as a whole. The practical consequence of the decision below, if applied to auditors by reason of their association with financial statements included in documents filed with the SEC, will be the exposure of auditors to potentially unlimited liability to an indeterminate class.

The decision below expands the scope of the remedies for violation of Section 10(b) beyond that specifically provided for by Congress in Section 18. Such expansion is detrimental to the administration of the carefully balanced enforcement scheme based on industry self-regulation, SEC oversight and enforcement, and private remedies, that was enacted and intended by Congress.

The Institute seeks leave to file its *amicus* brief to demonstrate that the implication of a private remedy under Section 10(b) beyond the contours of Section 18 in this instance is not required or permitted by any correct interpretation of the statute or the legislative history, is not consistent with the governing precedents of this Court and is a matter of sufficient doctrinal and practical importance to warrant the issuance of the writ.

Respectfully submitted,

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KALMAN ROSS and ANITA ROSS,
Respondents.

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

October Term, 1979

No. 79-1428

A.H. ROBINS COMPANY, INC., *et al.*,

Petitioners,

vs.

KALMAN ROSS and ANITA ROSS,

Respondents.

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae,* in support of the Petition for a Writ of Certiorari, and urges this Court to review the Opinion and Judgment of the United States Court of Appeals for the Second Circuit entered in these proceedings on September 24, 1979.

Opinions Below

The opinion of the Court of Appeals reversing the decision of the District Court and remanding the case is officially reported at 607 F.2d 545 (2d Cir. 1979).

Question Presented

The three questions presented in the Petition for Certiorari[1] may be combined as follows:

> May civil liability for misleading statements in documents filed with the SEC be judicially implied under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(a) (the "1934 Act") in favor of open market purchasers and sellers of securities beyond that provided by Congress in Section 18 of the 1934 Act, 15 U.S.C. Section 78r, when the plaintiff did not rely on such documents?

Interest of the Institute as *Amicus Curiae*

The Institute is the only national accounting association whose membership is limited to certified public accountants; it has approximately 155,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in the pursuit of that purpose, the Institute has come to be accepted as the authoritative source of standards and procedures in its field. Most particularly, the Institute develops Generally Accepted Auditing Standards which form the standard of professional conduct for independent public accountants associated with financial statements, including those filed with the Securities and Exchange Commission.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed with respect to documents filed with the SEC. The Institute was invited to and did present its views before

[1] The Institute has not formulated and does not express any position with respect to the other issues that may be subsumed in the issues presented by petitioners.

the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act (*Hearings on S. Res. 84 (72nd Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate,* 73rd Cong., 1st Sess., pt. 15 at 7207-10 (1934) (the "1934 Hearings")) and, more recently, was accorded permission by this Court to file briefs *amicus curiae* in *Touche Ross & Co.* v. *Redington,* —— U.S. ——, 99 S. Ct. 2479 (1979) and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

The implications of the holding below sanctioning a market impact theory of liability under Section 10(b) and allowing purchasers and sellers of securities to invoke a private cause of action under Section 10(b), and the implications of the unsatisfactory analysis upon which that holding was reached, transcend the interests of the parties litigant and are of disturbing significance to the accounting profession as a whole. The Institute here contends that the question of whether such a private right of action under Section 10(b) may lie under the facts of this case should be addressed at this stage prior to the growth of a "market impact" theory of liability into a "judicial oak" of even larger proportions than that which prompted the concern of this Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 737 (1975) (*"Blue Chip"*). The holding below substitutes judicial preference for congressional intent as derived from the statute and legislative history. Because of the importance of this issue to the administration of the securities laws, this Court should address it.

Statement

A.H. Robins Company, Inc. ("Robins") is alleged to have misrepresented the effectiveness and safety of one of its products in its 1971 and 1972 Forms 10-K filed with the

SEC. Plaintiffs purchased 100 shares of Robins common stock in July 1973 over the New York Stock Exchange from third parties and sued, on March 23, 1977, on behalf of themselves and all purchasers of such stock from April 1972 through July 1974 when Robins allegedly first began to reveal that serious problems existed with the product. The amended complaint alleged that the defendants violated Section 10(b) of the 1934 Act and Rule 10b-5. Plaintiffs, however, do not claim that they ever saw or relied upon the filed statements alleged to be misleading. Rather, their theory is that the market reflected the misleading nature of Robins' statements.

The district court dismissed the amended complaint for failure to state a cause of action for violation of Section 10(b) and Rule 10b-5 and for failure to satisfy the pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure. In dismissing for failure to state a claim, the district court reasoned that Section 10(b) and Rule 10b-5 liability with respect to statements filed with the SEC could be no broader than the express cause of action provided in Section 18 of the 1934 Act. Thus, the court held that since Section 18 requires reliance, no cause of action had been stated.

On appeal, the Second Circuit held that maintenance of a cause of action under Section 10(b) and Rule 10b-5 would not nullify the terms of Section 18. It observed that under Section 10(b), scienter must be alleged and proved, while the presence of good faith and the absence of knowledge are defenses under Section 18. To the court, the shift of the burden of proof to the plaintiff in Section 10(b) cases helps to protect investors and "provides a rationale for dispensing with the reliance requirement inherent in § 18." 607 F.2d at 556.

REASONS FOR GRANTING THE PETITION

A.

The Holding Below Conflicts With Congressional Intent as Established Through Application of Governing Precedents of This Court.

Definition of the contours of liability under Section 10(b) brings to the fore an analytical process examining the language of the statute and its legislative history and taking into account the scheme of SEC enforcement, self regulation and express civil remedies created by Congress. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) ("*Hochfelder*"); *Blue Chip, supra. See also Touche Ross & Co.* v. *Redington*, —— U.S. —— , 99 S. Ct. 2479 (1979) ("Redington").[2]

Implication of a private cause of action in damages under Section 10(b) and Rule 10b-5 to create liability on a "market impact" theory in the absence of actual reliance finds no warrant in the provisions of the 1934 Act. The statute itself indicates that civil liability in damages with respect to misleading documents filed with the SEC was not to be created in favor of anyone who bought or sold a security without having relied upon those documents. The 1934 Act as a whole represents a sharply drawn congressional balance apportioning enforcement among administrative regulation, self-enforcement and liability to third

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[2] The importance of these contours cannot be understated. In the words of this Court, per Justice Frankfurter addressing a similar analytical setting:

> "[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequencies of his deviation from duty?"

Securities and Exchange Commission v. *Chenery Corp.*, 318 U.S. 80, 85-86 (1943).

parties. The legislative history persuasively confirms that Congress did not intend the construction advanced by the court below. It further shows that Congress, as part of its regulatory scheme, carefully circumscribed private rights of action in a fashion precluding the claims asserted here.

(i) The Text of the Statute Demonstrates Congressional Intent to Narrowly Circumscribe Civil Liability in Damages

This Court has repeatedly emphasized, particularly with respect to the securities laws, that "[t]he starting point in every case involving construction of a statute is the language itself." *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 472 (1977), quoting *Hochfelder, supra,* 425 U.S. at 197, quoting *Blue Chip, supra,* 421 U.S. at 756 (Powell, J., concurring).[3]

In Section 18(a) of the 1934 Act, Congress expressly limited liability for misleading statements contained in documents filed with the SEC. In addition to exculpating defendants acting in good faith, the section limits the class of persons to whom defendants may be liable to those who purchased or sold "in reliance upon [the false or misleading] statement . . . at a price which was affected by such statement." The language employed by Congress thus sets forth a "double-barreled causation requirement."[4] A plaintiff must establish 1) that he relied upon the statement, and 2) that the statement affected the market price. Nowhere in the 1934 Act did Congress indicate any intention to

[3] For related authorities affirming this elementary canon of construction, see *Cannon* v. *University of Chicago,* 441 U.S. 677, 689 (1979); *United States* v. *Bass,* 404 U.S. 336, 339 (1971); Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Colum. L. Rev. 527, 543 (1947).

[4] *Rich* v. *Touche Ross & Co.,* 415 F. Supp. 95, 103 (S.D.N.Y. 1976).

broaden the contours of such liability to cover those who merely purchased or sold "at a price which was affected by such statement".

The language of Section 10(b) says nothing in support of eliminating the reliance requirement. Reliance and scienter are the hallmarks of fraud[5] and, as this Court took pains to explain in *Hochfelder, supra,* 425 U.S. at 198, 212 n.32, manipulation, deception and contrivance as utilized in Section 10(b) are active terms, implying actual deception, totally contrary to the effect-oriented approach urged by the SEC. Those terms similarly give no hint that reliance is to be disposed of.

Acknowledgement by the court below that plaintiffs did not rely on the misleading statements is thus a concession that its holding goes beyond the express terms of the 1934 Act. Further inquiry is thus unnecessary. *See United States* v. *Campos-Serrano,* 404 U.S. 293, 297-98 (1971); *United States* v. *Bass, supra* note 3, 404 U.S. at 339; *Toussie* v. *United States,* 397 U.S. 112, 120-22 (1970); *United States* v. *Oregon,* 366 U.S. 643, 648 (1961).

(ii) The Legislative History: Congress did not Intend Civil Liability in Damages to the Market as a Whole

The legislative history demonstrates that Congress meant what it said in Section 18 in limiting liability for misleading statements filed with the SEC to those who relied on them.

The versions of Section 18 passed by both the House and Senate contained the actual formulation found in Section 18 in its final form. Both the Senate Report[6] and the

[5] *See* Restatement of Torts § 525 (1938).

[6] S. Rep. No. 792, 73rd Cong., 2d Sess. 21 (1934).

House Report[7] affirmed that liability in damages with respect to misleading statements contained in filed documents lies in favor of "a person who in reliance on the statement and in ignorance of its false and misleading character has purchased the security to which it relates at a price affected by it." And, as the Senate Report added, "the burden is on the plaintiff to show . . . the fact that the statement was false or misleading, and that he relied thereon to his damage." S. Rep. No. 792, 73rd Cong., 2d Sess. 13 (1934).

This consistent uniformity speaks not of indifference to potential liability to the market at large but of a conscious intent to restrict such liability. An earlier version basing liability only upon the absence of good faith and proof that the stock price was affected by a misstatement was "very much challenged on the ground that reliance should be required." 78 Cong. Rec. 7701 (1934). This restriction was insisted on, for example, by Chairman Rayburn of the House Committee on Interstate and Foreign Commerce in explaining the very bill he sponsored:

> "Mr. Hollister: The gentleman keeps referring to the issuer or the seller. This is a general clause and covers anybody making any kind of statement in any kind of document or in any kind of paper that is filed. It includes accountants, lawyers, or any other expert.
>
> * * *
>
> [A request of additional time was made]
>
> Mr. Rayburn: I want to read this part of the section to the gentleman:
>
> Who, in reliance upon the statement, shall have purchased or sold a security.

[7] H. R. Rep. No. 1383, 73rd Cong., 2d Sess. 25 (1934).

> Mr. Hollister: Yes; that is the man who is going to sue. I am talking about the report that is made. This refers to any statement that is made in any report under this bill, if it contains a misleading statement.
>
> Mr. Rayburn: If upon that report somebody bought or sold a security and lost money relying upon the statement that was false."

78 Cong. Rec. 8040 (1934).

Even with these limitations, the drafters of the 1934 Act expressed the concern that Section 18 went too far. Thomas Corcoran, one of its authors, and others were anguished over a long period of limitations which gave rise to the possibility of "blackmail". 1934 Hearings at 6565 (1934). The Institute expressed its concern over the amount of damages originally provided. *Id.* at 7207-10. These matters were addressed and the civil liability provisions of the 1934 Act and of the Securities Act of 1933, 15 U.S.C. Sections 77a-77aa (the "1933 Act"), were accordingly tightened. *Blue Chip, supra,* at 736, 740-41.

The decision below is thus not supported by the legislative history. Liability to the market on the basis of impact on trading prices was expressly rejected by Congress.

(iii) The Extrinsic Evidence From the Texts of Other Sections of the 1934 Act Shows the Error of the Holding Below

The interrelated nature of the various sections of the 1934 Act makes instructive an examination of the limitations on civil liability found in the Act. Since Section 10(b) is flanked by provisions creating private causes of action containing express limitations, this Court has

been "extremely reluctant to imply a cause of action in [another section] that is significantly broader than the remedy that Congress chose to provide." *Redington, supra,* 99 S. Ct. at 2488; *see also Blue Chip, supra,* 421 U.S. at 735-36.

With respect to plaintiffs' allegations that they purchased securities at prices affected by misleading reports filed with the SEC, Congress addressed the issue of filed misleading statements in Section 18 and the issue of manipulation in Section 9. The language employed in Section 18 and the congressional intent to preclude liability for market impact is clear. The holding below thus conflicts with this Court's holding in *Redington* that the language and intent of Section 18 are virtually conclusive in determining whether civil causes of action in damages under other sections of the 1934 Act may be implied.

This conclusion is further supported by the observation that where Congress intended to impose liability for false statements having market impact it knew how to do so. In Sections 9(a)(4) and 9(e) Congress expressly provided civil liability in damages for misleading statements having market impact. The persons subject to that liability, however, were limited by Congress to actual participants in securities transactions.[8] This carefully drawn limitation would be negated by interpretation of Section 10(b) to subject all those who merely file documents with the SEC and,

[8] Section 9(a)(4) makes it unlawful for "a dealer or broker, or other person selling or offering for sale or purchasing" a security registered on a national exchange to make a misleading statement to induce the purchase or sale of that security. That limitation of liability in market impact cases to participants in securities transactions was reinforced in Section 9(e). There Congress provided that "[a]ny person who willfully participates in any [such] act or transaction" is subject to civil liability in damages.

like accountants, are associated with such documents, to civil liability in damages.[9]

B.

The Decision Below Raises Disturbing Policy Implications That Should be Addressed by This Court.

It is against this background of uniform congressional refusal to permit liability to market purchasers per se, except as against participants in securities transactions as in Sections 9(a)4 and 9(e), that the decision below must be assessed. In relying on a shift of the burden of proof with respect to scienter in order to avoid Section 18, the court failed to correctly read the numerous significant decisions of this Court, some of which have reversed the Second Circuit,[10] requiring it to analyze the statutory language and history. Congress' intent to limit civil liability in damages was far more pervasive than recognized by the court below. Mere switch of the burden of proof on scienter can hardly justify judicial expansion of the judicially created cause of action under Section 10(b) to create a liability forsworn by Congress.

[9] Section 11 of the Securities Act of 1933 also creates liability in a strictly limited manner for misleading statements having market impact. As originally enacted, the Section provided a private right of action in damages to market buyers of registered securities where the registration statement contained a material untruth or omission, without regard to reliance. However, in 1934 Congress further restricted that cause of action by requiring the purchaser to show reliance on the prospectus once an earning statement covering a period of at least twelve months had been made generally available to security holders. Pub. L. No. 291, 48 Stat. 907 (73rd Cong. 1934). Thus, Congress in 1934 restructured Section 11 to fit the reliance requirement of Section 18 which pertains to annual reports filed with the SEC.

[10] *Redington, supra; Santa Fe Industries, Inc.* v. *Green, supra; Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977). *See also, Transamerica Mortgage Advisors, Inc.* v. *Lewis,* ____ U.S. ____, 100 S. Ct. 242 (1979).

Furthermore, the court's rationale in dispensing with reliance in market impact cases makes this case profoundly disturbing. Were scienter to be limited to actual intent to deceive, the rationale might be understandable if considered alone without regard to the congressional intent discussed *supra*. Several circuit courts, however, since this Court's decision in *Hochfelder*[11] have held that proof of recklessness may satisfy the scienter requirement in nearly all circumstances.[12] Yet the court below failed to articulate any justification for dispensing with reliance in recklessness cases.

By permitting possible liability upon proof of recklessness without requiring proof of reliance, the court below potentially subjected those, such as accountants who are associated with documents filed with the SEC, to "a liability in an indeterminate amount for an indeterminate time to an

[11] This Court in *Hochfelder* held that liability under Section 10(b) required pleading and proof of scienter by the plaintiff and defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud". It left open "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." *Hochfelder, supra,* 425 U.S. at 194 n.12.

In *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972), this Court did not dispense with the reliance requirement. Instead, the decision in *Ute* provides merely that no causation in fact need be shown in the context of face to face dealings where a material fact is withheld in violation of an obligation to disclose. The decision in *Ute* is thus of little relevance to an analysis of the propriety of a reliance requirement in market cases not involving face to face dealings.

[12] *See, e.g., Mansbach* v. *Prescott, Ball & Turben,* 598 F.2d 1017, 1023-24 (6th Cir. 1979); *Nelson* v. *Serwold,* 576 F.2d 1332, 1337 (9th Cir.), *cert. denied,* 439 U.S. 970 (1978); *Rolf* v. *Blyth, Eastman Dillon & Co.,* 570 F.2d 38, 44 (2d Cir.), *cert. denied,* 439 U.S. 1039 (1978); *Coleco Industries, Inc.* v. *Berman,* 567 F.2d 569, 574 (3rd Cir. 1977), *cert. denied,* 439 U.S. 830 (1978); *First Virginia Bankshares* v. *Benson,* 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied sub nom., Walter E. Heller & Co.* v. *First Virginia Bankshares,* 435 U.S. 952 (1978); *Sundstrand Corp.* v. *Sun Chemical Corp.,* 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied,* 434 U.S. 875 (1977).

indeterminate class".[13] Upon an allegation of recklessness, as upon an allegation of negligence,

> "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences."[14]

The desire of the court below to protect public investors fails to answer these concerns. The court's admitted decision to expand Section 10(b) in order to protect investors takes no account of the evident congressional decision to leave market impact cases to the enforcement branch of the SEC and disturbingly fails to recognize the potential exposure that its reasoning creates for those experts associated with filed documents.

Moreover, liability to the market on the basis of recklessness leaves auditors and others who are concerned with fulfilling their responsibilities under the securities laws with little if any guidance. The process of auditing the financial statements of a company does not yield absolute certitude about the result. The audit function proceeds by a process of sampling, which in turn rests upon the experience, expertise and informed judgment of the auditor. So barely defined is recklessness in application to the exercise of expert judgment[15] that its use, without the limitation of actual reliance, raises concerns at least equal to the concern for protecting investors articulated by the court below. Yet the decision makes no attempt to assess these factors or to draw an appropriate balance.

[13] *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931) (Cardozo, C.J.).

[14] *Id.* at 179-80; 174 N.E. at 444.

[15] *Pegasus Fund, Inc.* v. *Laraneta,* [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,281 (9th Cir. 1980).

This Court has frequently granted certiorari to review cases where the issue was important to the administration of the federal securities laws. *See Santa Fe Industries, Inc.* v. *Green, supra,* at 471; *Hochfelder, supra; Blue Chip, supra.* Where review was necessary to correct an important doctrinal problem, this Court has not hesitated to do so despite the nonfinality of the judgment sought to be reviewed. *E.g., Blue Chip, supra; Hochfelder, supra; United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837 (1975).

The holding below raises such sharp concerns requiring this Court's review at this stage. It contradicts the intent of Congress, expressed in Section 18 and in the legislative history, to preclude market-wide civil liability in damages absent actual reliance. And it poses grave implications to the scheme of SEC enforcement and private civil remedies enacted and intended by Congress.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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A. H. ROBINS COMPANY, INC., *et al.*,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND BRIEF *AMICI CURIAE*

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MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Shearson Loeb Rhoades Inc. ("Shearson"), Paine, Webber, Jackson & Curtis Incorporated ("Paine Webber"), E. F. Hutton & Company Inc. ("Hutton") and Dean Witter Reynolds Inc. ("Dean Witter"), hereby respectfully move, pursuant to Rule 42 of the Rules of this Court, for leave to file the annexed brief *amici curiae* in support of the petition for a writ of certiorari. The consent of counsel for the petitioners has been obtained. Consent of counsel for the respondents has been requested and refused.

The *amici curiae* are registered broker-dealers in securities which maintain nationwide branch office systems and which participate in the underwriting of securities in nationwide syndicates. Each of the *amici* or its parent holding company is also an issuer of securities which are listed and traded upon the New York Stock Exchange. As such, the *amici* have a substantial interest in the nature and scope of liabilities that may be inferred from the antifraud provisions of the federal securities laws. In addition, certain of the *amici* are defendants in various class actions pending in several of the United States District Courts which purport to state claims under the antifraud provisions of the federal securities laws based either solely upon a "fraud on the market" theory or as an alternative basis for relief in addition to claims based upon the express liability provisions of the federal securities laws. Each of the *amici* is therefore acutely interested in having this Court resolve the questions presented by the Petition: (i) whether an action may be maintained under the antifraud provisions of the federal securities laws which would otherwise be barred or substantially restricted if it were required to be maintained under the express liability sections provided by Congress in the Securities Act of 1933, 15 U.S.C. §§77a *et seq.* (the "1933 Act"), or the Securities Exchange Act of 1934, 15 U.S.C. §§78a *et seq.* (the "1934 Act"); and (ii) whether proof of reliance is a necessary element of an action based upon the antifraud provisions of those Acts.

Broad class actions based upon the antifraud provisions of the federal securities laws, maintained without regard to the substantive provisions of the express liability provisions of those laws, continue to plague the securities industry and particularly the major broker-dealers which account for a substantial portion of all securities trading and underwriting activity.

The *amici* believe that the Court of Appeals for the Second Circuit seriously erred in permitting the maintenance of a judicially inferred right of action under Section 10(b) of the 1934 Act, 15 U.S.C. §78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5, where plaintiffs had been provided by Congress with an express remedy under Section 18 of the 1934 Act, 15 U.S.C. §78r, with which they could not comply because of their conceded nonreliance on the filing with the Securities and Exchange Commission (the "SEC") of which they complain and because their action would have been barred by the periods of limitations provided in subsection (c) of Section 18 of the Act. It is also submitted that the Court of Appeals, in eliminating the unquestioned requirement of reliance for maintenance of an action based upon the antifraud provisions of the federal securities laws, opened the gate to a flood of massive class actions which this Court has attempted to stem. The Second Circuit's ruling, it is submitted, substantially undercuts this Court's recent decisions in *Cannon* v. *University of Chicago,* 441 U.S. 677 (1979); *Touche Ross & Co.* v. *Redington,* 99 S. Ct. 2479 (June 18, 1979); and *Transamerica Mortgage Advisors, Inc.* v. *Lewis,* 100 S. Ct. 242 (Nov. 13, 1979).

The *amici* urge that it is appropriate for this Court unequivocally to instruct the lower federal courts that resort may not be had to the antifraud provisions of the federal securities laws where Congress has provided an express remedy for the conduct complained of and that reliance is an essential element of any claim based upon the antifraud provisions of the federal securities laws.

WHEREFORE, Merrill Lynch, Shearson, Paine Webber, Hutton and Dean Witter respectfully move this Court that

leave be granted to them to file the annexed brief *amici curiae.*

Dated: March 17, 1980

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1428

A. H. ROBINS COMPANY, INC., *et al.*,

Petitioners,

v.

KALMAN ROSS and ANITA ROSS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

Merrill Lynch, Pierce, Fenner & Smith Incorporated, Shearson Loeb Rhoades Inc., Paine, Webber, Jackson & Curtis Incorporated, E. F. Hutton & Company Inc. and Dean Witter Reynolds Inc. submit this brief as *amici curiae,* in support of the petition for a writ of certiorari, and urge this Court to review the judgment and opinion of the United States Court of Appeals for the Second Circuit in *Ross* v. *A. H. Robins Company, Inc., et al.,* 607 F.2d 545 (2d Cir. 1979).

Interest of the *Amici Curiae*

The *amici curiae* are all registered broker-dealers in securities which maintain nationwide branch office systems and which participate in the underwriting of securities in nationwide and international syndicates. Each of the *amici* or its parent holding company is also an issuer of securities which are listed and traded upon the New York Stock Exchange. The *amici,* both as broker-dealers in actively traded securities and as issuers of such securities, have a substantial interest in the nature and scope of liabilities that may be judicially inferred from the antifraud provisions of the federal securities laws.

Moreover, currently and from time to time in the past, certain of the *amici* have been named as defendants in class actions in the United States District Courts which purport to state claims under the antifraud provisions of the federal securities laws based upon a "fraud on the market" theory. These actions purport to be brought on behalf of numerous possible claimants, such as all purchasers or sellers of a listed and actively traded security over a period of years. Typically, the representative plaintiff merely alleges that a document filed with the SEC contained material misrepresentations or omissions, but does not claim to have purchased or sold the security in reliance upon the alleged omission or misrepresentation. The "fraud on the market" theory is sometimes the sole basis for such suits and in other instances it is alleged as an alternative theory in addition to claims based upon the express civil remedies provided by Congress in the federal securities laws.

Thus, each of the *amici* is vitally interested in having this Court resolve the questions presented by the Petition: (i) whether an action may be maintained under the antifraud

provisions of the federal securities laws which would otherwise be barred or substantially restricted if it were required to be maintained under the express liability sections provided by Congress in the federal securities laws; and (ii) whether proof of reliance is a necessary element of an action based upon the antifraud provisions of the federal securities laws.

The *amici* respectfully urge this Court to issue a writ of certiorari in order to forestall the substantial and inappropriate expansion of judicially-created remedies invited by the extraordinary decision of the Court of Appeals below and thereby to call a halt to the filing of massive "fraud on the market" cases which continue to plague the securities industry.

The Second Circuit's decision cannot be squared with this Court's recent holdings in *Cannon* v. *University of Chicago,* 441 U.S. 677 (1979); *Touche Ross & Co.* v. *Redington,* 99 S. Ct. 2479 (June 18, 1979); and *Transamerica Mortgage Advisors, Inc.* v. *Lewis,* 100 S. Ct. 242 (Nov. 13, 1979). This Court should, therefore, grant review to ensure that the frustration of Congressional intent embodied in that decision is not compounded through other courts' reliance upon it, emanating as it does from a Circuit that has often been recognized as an influential voice in this area of the law.

ARGUMENT

I.

Where Congress Has Provided an Express Civil Remedy in the Federal Securities Laws, Resort to the General Antifraud Provisions Should Not Be Permitted By Those Who Cannot Meet the Requirements of the Express Civil Remedy.

The Court of Appeals erred in permitting an action to be maintained under Section 10(b) of the 1934 Act on the basis of conduct that would constitute a violation of Section 18 of that Act. While the Court of Appeals indicated its awareness of this Court's recent decisions in *Touche Ross & Co.* v. *Redington, supra,* and *Cannon* v. *University of Chicago, supra,* it totally ignored the central theme of those decisions: that Congressional intent, as evidenced by the language employed by the Congress and, if necessary, the legislative history of the statutes, is controlling, and that judicial improvement on the legislative scheme is wholly inappropriate.

The Court of Appeals arrived at its erroneous conclusion by resurrecting the tort analysis employed by the Second Circuit almost thirty years ago in *Fischman* v. *Raytheon Manufacturing Co.,* 188 F.2d 783 (2d Cir. 1951). The Court did so despite this Court's recent repudiation of that analysis in *Touche Ross & Co.,* where this Court said that the inquiry into whether a private remedy may be inferred from a federal statute begins and ends with the statute itself, and that:

> ". . . implication of a private right of action based on tort principles, therefore, is entirely misplaced."

99 S. Ct. at 2485. In *Fischman,* the Second Circuit held that, although plaintiffs could not maintain an action under Section 11 of the 1933 Act based upon a registered public offering of securities because they had not purchased securities which were the subject of the registration statement, they could nevertheless pursue an action under Section 10(b) of the 1934 Act if they "added the ingredient of fraud" to their complaint. 188 F.2d at 787.[1] The Court based its holding on Section 286 of the Restatement of Torts and *Kardon* v. *National Gypsum Co.,* 69 F. Supp. 512 (E.D. Pa. 1946), the seminal decision utilizing tort principles (and also based upon the Restatement) to find a judicially implied cause of action under Section 10(b) and Rule 10b-5. But, just as SIPC's reliance on the tort analysis in *Touche Ross & Co.* was "entirely misplaced", so too was the Court of Appeals' reliance below upon *Fischman* v. *Raytheon Manufacturing Co.*

The Court of Appeals' error is underscored by the fact that while a petition for rehearing was pending before the Court in this case, this Court's decision in *Transamerica Mortgage Advisors, Inc.* v. *Lewis, supra,* was furnished to the Court of Appeals by the petitioners, but nevertheless their petition for rehearing was denied. It would appear that the Court of Appeals will continue to engage in expansive readings of the federal securities laws, contrary to

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[1] The Second Circuit's statement that the "added ingredient of fraud" is sufficient to permit a Rule 10b-5 claim to be based on a registered public offering although plaintiffs could not meet the requirements of Section 11 of the 1933 Act is unconvincing. While it is true that only negligence need be proven to recover against an issuer under Section 11, if a plaintiff in fact proves a knowing misstatement in the registration statement then, of course, the due diligence defense available to certain categories of defendants under subsection (b)(3) of Section 11 could not be sustained. Accordingly, it is unnecessary to permit overlapping and inconsistent actions to be maintained under both Section 11 of the 1933 Act and Section 10(b) of the 1934 Act.

Congress' express remedial provisions, unless this Court unequivocally states, once again, that the federal courts are required to follow the dictates of Congress as to the availability of remedies under the federal securities laws and are required to enforce the limitations, and observe the exemptions, that Congress built into the assertion of such claims. The Court of Appeals totally ignored this Court's observation in *Touche Ross & Co.*, reiterated in *Transamerica Mortgage Advisors*, that "when Congress wished to provide a private remedy it knew how to do so and did so expressly." 99 S. Ct. at 2487; 100 S. Ct. at 248.

The Court of Appeals apparently believed that it was free of Congressional restrictions because, in its view, it was not "being asked to *create* a new remedy", 607 F.2d at 553 (emphasis in original), since it was already "well established" that a private remedy existed for violations of Section 10(b) of the 1934 Act and Rule 10b-5. It viewed its task as one of determining whether a person may "invoke an established remedy in the face of a statute which may, in certain circumstances, provide another remedy for the same conduct." 607 F.2d at 553. The Court's conclusion that it could permit the Section 10(b) action to proceed without "impermissibly nullify[ing] the limitations and requirements inherent in Section 18" was arrived at because the Court did not find this Court's decisions in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("Amtrak"); *Cort* v. *Ash*, 422 U.S. 66 (1975); and *Cannon* v. *University of Chicago*, *supra*, "particularly instructive", and after footnoting, but otherwise disregarding, *Touche Ross & Co.*

The Court of Appeals may have felt free to disregard this Court's opinions on the assumption that this Court had previously endorsed the proposition that a cause of action would always lie for a violation of Rule 10b-5, citing *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972). 607 F.2d at 552. But *Superintendent of Insurance* and *Affiliated Ute Citizens* each dealt with a defrauded *seller* of securities in a face-to-face transaction and did not raise the issue of whether a defrauded *buyer* of securities in an open-market transaction, for whom Congress had provided express civil remedies under the federal securities laws, could also avail himself of a remedy under Rule 10b-5. It is precisely this failure to distinguish between buyers and sellers of securities and open-market versus face-to-face transactions that apparently led the Court of Appeals to its erroneous interpretation of this Court's prior decisions. It is submitted that if these distinctions are observed in determining the circumstances under which an action may be maintained under Rule 10b-5, the "casual nullification" of the limitations on the express remedies provided by Congress, which some commentators have critically noted, can be wholly avoided. *See, e.g.*, 3 L. Loss, *Securities Regulation* 1787-91 (2d ed. 1961); 6 L. Loss, *Securities Regulation* 3915-17 (1969); and 1 A. Bromberg, *Securities Law: Fraud—SEC Rule 10b-5* §2.4(2) (1977).

For example, in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), Judge Kirkpatrick permitted the implication of a private damage remedy under Rule 10b-5 in favor of victims of an egregious scalping by corporate insiders perpetrated on the holders of the minority interest in a private company who were unaware of pending negotiations for a sale of the company's assets to National Gypsum at a substantial premium. As defrauded sellers of unlisted securities, the plaintiffs had no express remedies under the federal securities laws. In these circumstances, the Court first found that the insiders had clearly violated

the Rule[2] and then held, relying specifically on Section 286 of the Restatement of Torts, that a violation of the Rule necessarily gave rise to an action for damages cognizable in the federal courts. Judge Kirkpatrick's analysis in *Kardon* stands in sharp contrast to his later decision in *Rosenberg* v. *Globe Aircraft Corp.*, 80 F. Supp. 123 (E.D. Pa. 1948), where he prohibited the use of the more liberal venue provisions of the 1934 Act in an action allegedly based upon Rule 10b-5, but which he construed as invoking the express liability provisions of Sections 11 and 12 of the 1933 Act because the action was based upon a public offering of securities which had been registered under the 1933 Act. Whether or not Judge Kirkpatrick was initially correct in utilizing the tort analysis to provide a 10b-5 remedy to the defrauded sellers in *Kardon*, he was most assuredly correct in refusing to extend that remedy to the alleged defrauded buyer of a new issue of securities in *Rosenberg*. In *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 752 n.15 (1975), this Court itself contrasted *Rosenberg*, which refused to extend the *Kardon* tort analysis to a situation covered by an express 1933 Act remedy, with *Thiele* v. *Shields*, 131 F. Supp. 15 (S.D.N.Y. 1955), where the Court permitted a tort remedy under Rule 10b-5 in an action based upon a public offering of municipal securities although Congress had expressly exempted such securities from the registration and civil liability provisions of the 1933 Act. These citations were coupled with references to the previ-

[2] The defendants' conduct was precisely the type that the SEC intended to proscribe when it hastily promulgated the Rule in 1942. *See* 22 Bus. Law. 793, 922 (April, 1967) (remarks of Milton Freeman, one of the Rule's co-draftsmen). *See also* SEC Release No. 3230 (May 21, 1942), where the Commission stated that Rule 10b-5 was adopted to close a "loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase."

ously cited passages by Professors Loss and Bromberg, all three of which are critical of the notion that implied liabilities may broaden, or avoid the limitations of, the express civil liability provisions of the federal securities laws.

Although this Court may have "acquiesced" in *Superintendent of Insurance* in a 25-year history of "acceptance by the lower federal courts" of a judicially sponsored right of action under Section 10(b), it has never expressly acquiesced in such an action for a defrauded buyer or in respect of a publicly traded security. Thus, in *Superintendent*, this Court dealt with the sale of an insolvent insurance company's portfolio securities in the course of the looting of its assets by its unfaithful officers, and in *Affiliated Ute Citizens*, it dealt with face-to-face bargain basement sales by uninformed Indians to officers of a bank which acted as the tribe's transfer agent of the Indians' holdings of tribal securities. In granting relief under Rule 10b-5 in those situations this Court did not provide an implied remedy in addition to existing express remedies provided by Congress, nor did it make an end run around any limitations that Congress saw fit to place upon those remedies. Thus, in providing relief to the sellers in those private transactions, this Court did not do violence to the interrelated schema of the 1933 and 1934 Acts.

The questions raised by the instant Petition are quite different from those raised by those prior precedents. The Court is here presented with a unique opportunity to make clear that its prior holdings on Rule 10b-5 relate only to defrauded sellers in essentially face-to-face transactions. In so doing this Court could affirm that:

> "[I]t is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it. 'When a statute limits a thing to be done

in a particular mode, it includes the negative of any other mode.' *Botany Mills* v. *United States*, 278 U.S. 282, 289 (1929). See *Amtrak, supra*, 414 U.S., at 458; *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412, 419; *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 471."

Transamerica Mortgage Advisors, Inc. v. *Lewis*, 100 S. Ct. at 247. *See also Kissinger* v. *Reporters Committee for Freedom of the Press*, 48 U.S.L.W. 4223 (U.S. March 3, 1980), at 4226 & n.4. This, too, would be in keeping with the intention of Mr. Milton Freeman, who, as noted above, was one of the draftsmen of Rule 10b-5, and who recently expounded on this very point, as follows:

"In other words, the Securities Act of 1933 gave buyers of securities specific remedies; the Supreme Court so far has implied remedies under Rule 10b-5 only on behalf of sellers who, of course, had no express remedy under the Securities Act. There is some language which assumes that buyers may have an implied right under Rule 10b-5, but there have not been any cases upholding such a right. Justice Rehnquist specifically reserved this issue in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 n.15 (1975)."

M. Freeman, *The Liability of Professionals under Rule 10b-5*, 23 Pract. Law No. 4 at 45, 52 (June, 1977).

The legislative history of Section 18 of the 1934 Act, which is set forth in relevant part in the Petition, compels the conclusion that Congress wished to narrowly circumscribe the conditions under which a civil action for damages could be maintained for a deficient filing with the SEC. A proposed broad right of recovery available even to those who had not relied upon the filing (such as the respondents here) was specifically rejected by the Congress. In its stead, Congress provided for a double-barreled reliance requirement: the plaintiff must have relied upon a material misstatement in the filing, the price at which he bought or sold must have been affected by such misstatement *and* his recoverable damages are limited to those caused by his reliance on such misstatement.

Congress also rejected limitations periods which would have permitted an action to be brought within two years after the plaintiff's discovery of the misleading statement and within six years after the filing. This met with vehement objections on the basis that, in a down market, this afforded too much time for disappointed speculators to seek to transfer their losses on the basis of a fortuitous error in a previous filing. Again, Congress responded to the criticism by materially shortening the limitations periods to one year after discovery of the misstatement and within three years after the date of the filing.

All of this legislative debate and drafting has been rendered nugatory by the decision of the Court of Appeals which effectively reopened the federal courthouse doors to those who have neither relied upon a misleading filing nor brought their action seasonably. This is judicial rewriting of legislation of the baldest sort and flagrantly violates this Court's recent admonitions against judicial lawmaking. *See, e.g., Touche Ross & Co.*, at 2488; *Transamerica Mortgage Advisors, Inc.*, at 247.

The Court of Appeals' substitution of Rule 10b-5 liberality for the Congressional strictures of Section 18 of the 1934 Act should be rectified by this Court.

II.

Reliance Is a Necessary Element of a Claim Based on the Antifraud Provisions of the Federal Securities Laws.

The Court of Appeals held that "[i]n a §10(b) action, however, reliance is presumed once the materiality of an omission is established, *Affiliated Ute Citizens* v. *United States,* [406 U.S. 128 (1972)], or the material misrepresentation affected the price of stock traded on the open market". 607 F.2d at 553. In so holding, the Court of Appeals was, to our knowledge, the first to rule substantively that reliance may be presumed and thus to endorse the maintenance of an action based upon a "fraud on the market" theory.[3] Unless this decision is reversed, persons dealing in actively traded securities will continue to be subjected to unlimited class actions alleging simply that somewhere, at some time, a statement was made concerning the affairs of the issuer of a security and that such statement affected the market price of the security or "the integrity of the market". This is an open invitation to lawsuits whose dimensions are limitless and evokes the spectre of liability that Judge Cardozo foresaw in *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931): "liability in an indeterminate amount for an indeterminate time

[3] The Court relied on its prior decision in *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973) (a defeated tender offeror has standing to sue for damages under Section 14(e) of the 1934 Act), which this Court subsequently reversed in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), and the Ninth Circuit's opinion affirming a class action determination on the basis of a rebuttable presumption of reliance, *Blackie* v. *Barrack,* 524 F.2d 891 (9th Cir. 1975), *cert. denied,* 429 U.S. 816 (1976). The subsequent reversal of *Chris-Craft Industries, Inc.* by this Court renders the Court of Appeals' prior decision of doubtful authority, and the *Blackie* opinion raised the issue only in a procedural context.

to an indeterminate class." Judge Cardozo's observation concerning such open-ended liability may aptly be repeated here:

> "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences."

255 N.Y. at 179-180, 174 N.E. at 444.

By reading reliance out of actions based on Rule 10b-5 the Court of Appeals eliminated a fundamental element of common law fraud in what is essentially a fraud action for violation of a federal statute. *See Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). It transformed a personal action for damages for reliance upon a material misstatement or omission into a universal guarantee against market losses. It established the "scheme of investors insurance" which the Second Circuit itself had cautioned against in *List* v. *Fashion Park, Inc.,* 340 F.2d 457 (2d Cir.), *cert. denied sub nom. List* v. *Lerner,* 382 U.S. 811 (1965). The following quotation from *List* is instructive:

> "Assuredly, to abandon the requirement of reliance would be to facilitate outsiders' proof of insiders' fraud, . . . [b]ut this strikes us as an inadequate reason for reading out of the rule so basic an element of tort law as the principle of causation in fact."

340 F.2d at 463. The Second Circuit's statement in *Globus* v. *Law Research Service, Inc.,* 418 F.2d 1276 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970), is also apposite:

> "The [jury] instructions were sufficient to bring home the basic concept that causation must be proved else defendants could be held liable to all the world."

Cf. Titan Group, Inc. v. *Faggen,* 513 F.2d 234, 238-239 (2d Cir.), *cert. denied,* 423 U.S. 840 (1975) ("The parallel elements of materiality and reliance both serve to restrict the potentially limitless thrust of Rule 10b-5 to those situations in which there exists a causation in fact between the act and injury.")

The Court of Appeals based its broad remedy for securities traders on its perception of the "fundamental policies underlying the securities acts" and its belief that, if Congress were asked to consider the matter anew, it would concur in the need for such open-ended relief. But this Court just recently "emphasized that generalized references to the 'remedial purposes' of the 1934 Act will not justify reading a provision 'more broadly than its language and statutory scheme reasonably permit,' " *Touche Ross & Co.* v. *Redington,* 99 S. Ct. at 2490, and that it is not the function of the Courts " 'to fill any hiatus Congress has left in this area' ". 99 S. Ct. at 2490-91.

Finally, the Court of Appeals found support for its conclusion in the following policy "rationale":

> "We also believe that holding that plaintiffs must proceed under the terms of §18 because the statements were filed with the S.E.C. would encourage corporate managers to include their misrepresentations in material filed with the S.E.C., for the sole purpose of insulating themselves from liability under §10(b) and restricting the class of potential plaintiffs to the unlikely few who actually viewed and relied upon the misleading information."

607 F.2d at 556. To attribute to corporate management an intent to file false and misleading documents with the SEC, and thereby to expose themselves to criminal sanctions

under Section 32 of the 1934 Act, "for the sole purpose of insulating themselves from liability under §10(b) and restricting the class of potential plaintiffs" is a canard and nonsense. This attribution of base motives to all corporate management, we submit, exposes the dubious validity of the Court's reasoning which led it to dispense with the element of reliance, and is sufficient by itself to justify review of this unprecedented and erroneous judgment.

CONCLUSION

The *amici* respectfully urge that the Court issue a writ of certiorari to review the judgment and opinion of the Court of Appeals so that the Second Circuit, like the Fourth Circuit in *Stern* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 603 F.2d 1073 (4th Cir. 1979), the Third Circuit in *Collins* v. *Signetics Corporation,* 605 F.2d 110 (3d Cir. 1979), and the Ninth Circuit in *Jablon* v. *Dean Witter & Co.,* [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,296 (9th Cir. Feb. 29, 1980), will be required to acknowledge that "a free wheeling implication of private actions" is no longer permissible under the federal securities laws, *Stern,* 603 F.2d at 1085, that "[i]n interpreting liability provisions of [those] acts", it "must respect recent Supreme Court teachings that militate against excessively expansive readings", *Collins,* 605 F.2d at 113 and that this "Court's decisions in *Touche Ross* and *Transamerica* reflect a restrictive approach to implying private rights of action", *Jablon,* at 97,032. Judge Aldisert, whose dissent in *Cort* v. *Ash,* 496 F.2d 412 (3d Cir. 1974), was vindicated by this Court's unanimous opinion in *Cort* v. *Ash, supra,* said it best in his recent dissenting opinion in *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.,* [Current] Fed. Sec. L. Rep. (CCH) ¶97,268 (3d Cir. Jan. 29, 1980):

> "For a court inferior in a judicial hierarchy to *recognize* controlling precedent announced by a superior court is not enough; the court has a responsibility to *apply* that precedent to similar facts unless it sets forth reasons for not doing so."

Healey at 96,898 (Aldisert, J., dissenting; emphasis in original).

For the foregoing reasons, a writ of certiorari should be issued to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

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Respectfully submitted,

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